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FORTUNE

ISSUE 3.1.15

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IT IS NOT THE CRITIC
WHO COUNTS;

THE CREDIT BELONGS
TO THE MAN WHO IS
ACTUALLY IN THE ARENA,

WHO STRIVES VALIANTLY;

WHO ERRS, WHO COMES
SHORT AGAIN AND AGAIN;

WHO KNOWS
GREAT ENTHUSIASMS;

WHO SPENDS HIMSELF
IN A WORTHY CAUSE;

WHO AT THE BEST
KNOWS IN THE END

THE TRIUMPH OF
HIGH ACHIEVEMENT,

AND WHO AT THE WORST,

IF HE FAILS,
AT LEAST FAILS
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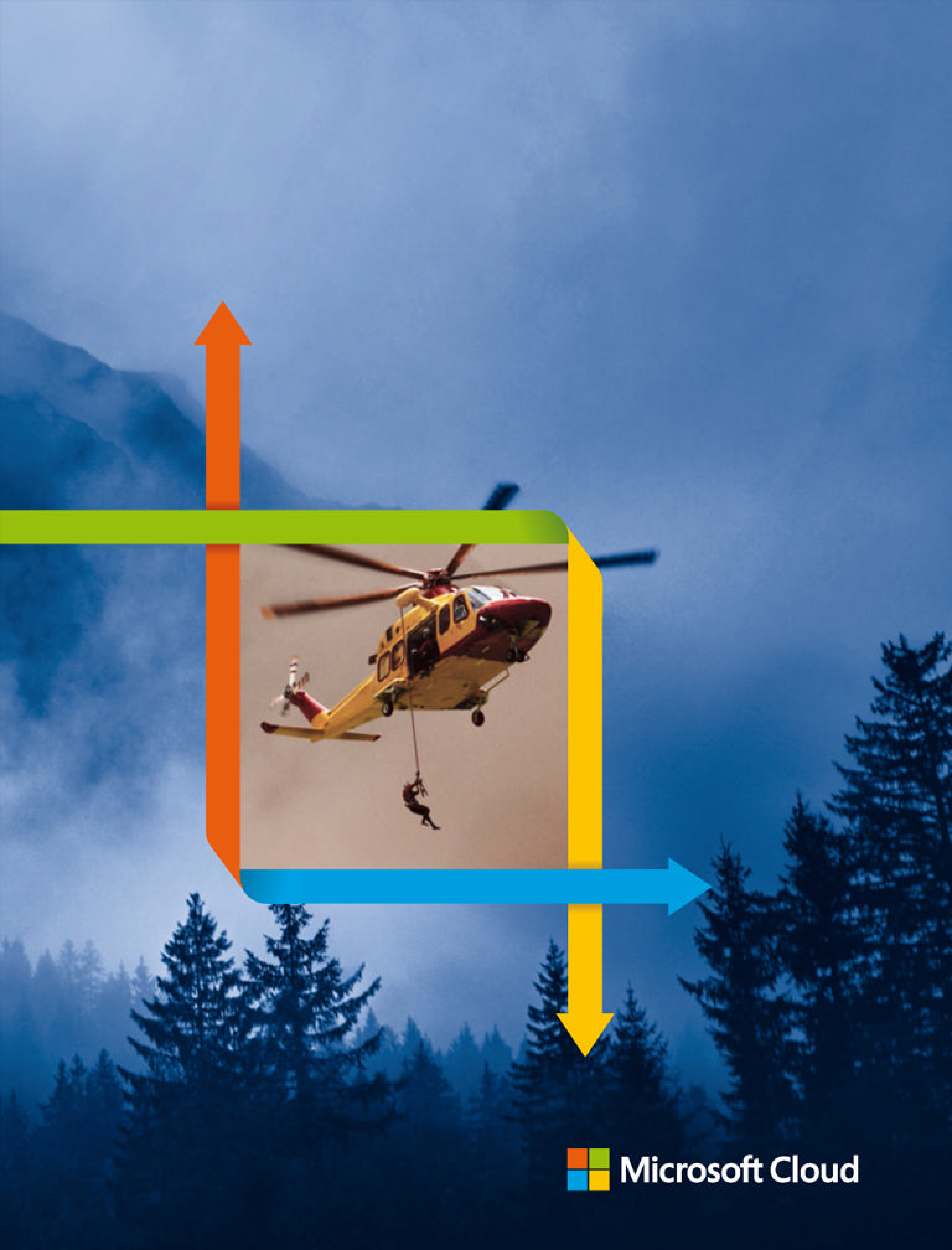
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March 1, 2015 Volume 171 Number 3

FORTUNE

ON THE COVER: PHOTOGRAPH BY **BARTHOLOMEW COOKE**

ON THIS PAGE: PHOTOGRAPH BY **GEORGE STEINMETZ**

The shale oil boom has transformed North Dakota's landscape. This hub near Williston collects oil by pipeline and exports it by train.

ON THE COVER: CAPITOL BUILDING BY DAVID A. DOBBS—GETTY IMAGES

March 1, 2015 Volume 171 Number 3

FORTUNE

29 New rules have made it easier for Americans to travel to Cuba, but luxury hotels like the Meliá Cohiba in Havana are rare on the island.

COURTESY OF MELIÁ HOTELS INTERNATIONAL


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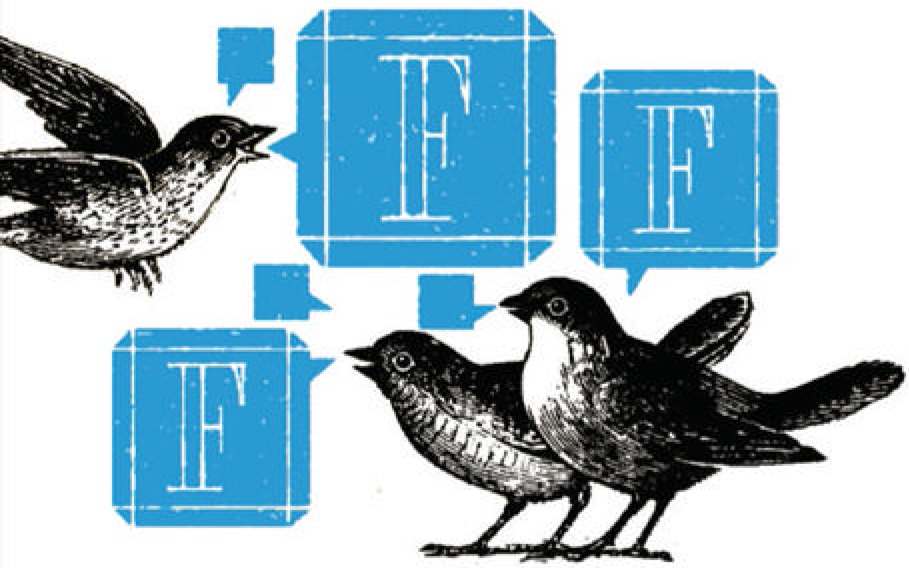

TWEETING OUR OWN HORN

OUR STAFFERS LOVE TO TALK ABOUT THE GREAT STUFF ON FORTUNE.COM. HERE'S A ROUNDUP OF SOME OF OUR FAVORITE TWEETS ABOUT *FORTUNE* STORIES. WANT TO FOLLOW OUR STAFF? CHECK OUT THE *FORTUNE* FOLKS' TWITTER LIST AT **TWITTER.COM/FORTUNEMAGAZINE/LISTS/FORTUNE-FOLKS.**

Dan Primack **@danprimack**
I was (very) wrong about private equity regulation

Adam Lashinsky **@adamlashinsky**
Can Apple still be cool if its products dominate your life?

Andrew Nusca **@editorialiste**
I just love that companies are warring over your late-night Chinese takeout

Stephen Gandel **@stevengandel**
Without energy, earnings are expected to be up 10.4%, vs. 4% in 2014. Just saying.

Michal Lev-Ram **@mlevram**
Who runs the (VC) world? Definitely not girls.

Erin Griffith **@eringriffith**
2012: Twitter buys Vine for ~30m 2015: Twitter buys Vine agency for ~$45m

BE AN INSIDER

Looking for some advice? *Fortune* Insider is an online community where some of the biggest names in business and beyond answer timely career and leadership questions, from what millennnials should know about the workforce to the best ways to network. See answers from HP CEO Meg Whitman, Barbara Bush of Global Health Corps (above), and Airbnb's Brian Chesky at fortune.com/fortune-insider.

TECH GETS PERSONAL

Wondering if that OS upgrade is worth it? Don't know how to print from your iPhone? Fortune.com is here to help. Jason Cipriani's weekly column, Logged In, looks at the nuts and bolts of making tech work for you. Find it at fortune.com/loggedIn.

BUSH: ASTRID STAWIARZ—GETTY IMAGES

ILLUSTRATION BY **PEP MONTSERRAT**

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NET NEUTRALITY AND THE VOICE OF BUSINESS

THE LATE BOB STRAUSS, a political wise man back when there was such a thing, used to tell fellow Democrats that they would never be the party of business, but that they could not succeed if all business was united against them.

President Obama has worked to disprove that thesis over the past six years, alienating almost every corner of the business community at one time or another. But last month the President dipped into Strauss's divide-and-conquer playbook by taking sides in the bruising business battle over net neutrality. At the President's urging, FCC chairman Tom Wheeler announced in *Wired* magazine—an unusual but amicable venue for the decision—that he was imposing a 1930s regulatory law on broadband operators like Comcast and Verizon, to the benefit of the tech companies that offer digital wares over the Internet. The goal is to prevent the broadband companies from blocking certain types of digital content, or providing paid "fast lanes" for others.

At the risk of a troll attack, let me say I've never understood the purists' argument for net neutrality. I've heard it propounded with passion by intelligent people—most recently Sir Tim Berners-Lee, the inventor of the World Wide Web, who lambasted telecommunication executives as "toll-takers" at a session I moderated at the World Economic Forum in Davos this year.

But as an economic matter, I don't see why broadband providers should be denied the pricing flexibility allowed airlines or Uber or others. While the government has fair reason to worry about the duopoly that dominates broadband service to homes, rapidly expanding wireless services—not to mention efforts like Google's to provide broadband by hot-air balloons—suggest this is still fertile ground for innovation. Treating broadband providers as dumb pipes, of the sort contemplated by lawmakers when they regulated telecommunications more than 80 years ago, could throttle that innovation.

As a political matter, the President's decision is easy to understand. The tech crowd shares his social agenda, if not always his economic or national security goals. Moreover, tech nerds are the cool kids in today's business world, while broadband providers are often viewed as bothersome bullies. Verizon added a kick of karmic justice to the President's plan by successfully suing to stop a more nuanced approach previously proposed by FCC chairman Julius Genachowski—a move the company must now regret.

But economic regulation shouldn't be settled by popularity contests. Even though Wheeler has promised forbearance, the FCC's regulatory overreach reflects a more general shift in the U.S. government's approach to business, reversing the deregulatory trends that fed prosperity in the 1980s and '90s. That, in turn, has grown out of a populist fever swelling on both sides of the political aisle that increasingly leaves business—particularly big business—without a clear voice in Washington. Armies of business lobbyists and their congressional allies still win many of the self-interested battles that occur in backrooms—protecting tax breaks, winning government contracts, and the like. But on the big issues that determine the future of the nation—trade, education, immigration, energy, budget policy, tax policy—the voice of business has diminished, as Tory Newmyer chronicles on page 116. That's unfortunate, as business exerts a pragmatic influence much needed in a political debate dominated by the ideologues of the left and right.

On a separate matter, this issue of *Fortune* includes an homage to our roots. The magazine grew up in the Great Depression, with writers like James Agee and photographers like Walker Evans and Margaret Bourke-White who chronicled those difficult times. With that in mind, we sent senior editor Jennifer Reingold and photographer George Steinmetz to see how the bust in oil prices was affecting the new boomtowns of North Dakota. You can find their report—"Waiting for the Reckoning"—on page 74.

ALAN MURRAY
Editor
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PHOTOGRAPH BY **WESLEY MANN**

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IS JONATHAN BUSH IN A BUBBLE?

THE ATHENAHEALTH CEO BELIEVES HIS COMPANY CAN BECOME THE AMAZON OF HEALTH CARE. BUT HEDGE FUND MANAGER DAVID EINHORN AND OTHERS ARE BETTING THAT HIS SOARING STOCK IS READY TO BURST.

by JEN WIECZNER

THE GOOFBALL IN CHARGE

Re "Is Jonathan Bush in a Bubble?" (Jan. 1): As CEO of Smart Scheduling, the first company in Athenahealth's new startup accelerator, I think that Jonathan's unorthodox leadership approach rings authentic. Jokes aside about his beer parties up in Maine, the point is that Smart Scheduling has found both Jonathan and the More Disruption Please program to be instrumental in helping my company grow, improve the service we offer, and start to make our own mark on health care.

Chris Moses
Watertown, Mass.

ON HIGH-STAKES TESTING

I don't blame Pearson for attempting to recast global education ("Everybody Hates Pearson," Feb. 1). The company is acting a lot like Wall Street, trying to make a few billion bucks doing what the law allows, no matter what public opinion says. It's what happens in a capitalistic society. I say tax the hell out of them all and give the revenue to the schools. If blame is your game, point a finger at the politicians who brought us this No Child Left Behind nonsense.

Tom King
via Fortune.com

THE END OF SERENDIPITY?

"The Algorithmic CEO" (Feb. 1) reminds me of the movie *The Imitation Game*. Without a doubt, predictive analytics is the next big thing in tech. With adequate knowledge of past events, precursors, drivers, and influencing factors, we'll be able to predict many outcomes or estimate their probability. What a strange world that will be when surprise becomes the occasional visitor in our lives!

Chad L. Hoffman
via Fortune.com

BEHIND THE MAGIC

Great work on "Empire of Tech," your fascinating January cover story about Bob Iger. I had no idea about the innovations Iger is bringing to Disney. A very well-researched article.

Rajeev Nair
Los Angeles

A BIG FAT "F"

Re "For-Profit Schools Are a Bad Deal for Both Investors and Taxpayers" (Jan. 1): Sheila Bair's article is the most enlightening I have yet read on the subject. Her statistics are mind-boggling. If only more mainstream media would consider and print numbers like that, this gigantic rip-off could be stopped.

Charles F. Quinn
Chadds Ford, Pa.

Back in the '70s I worked closely with returning Vietnam vets, who were subjected to many trade-school scams. Once the vet signed on, he was hooked for his GI Bill, as well as being cheated by incompetent trainers or teachers. It doesn't surprise me at all that such for-profit scamster schools of a similar nature are still allowed to do business.

Dan Fajardo
Salinas, Calif.

WE'LL DRINK TO THAT

Re "A Self-Made Heiress" (Dec. 22): Thank you for an excellent article on Charlene de Carvalho, her family, and how they are successfully heading up Heineken. A family-run business at its best! Her ancestors would be so proud.

Jim Cihowiak
Appleton, Wis.

CORRECTION

"The Age of Unicorns" (Feb. 1) misstated Fab's 2013 revenue. It is $100 million. In the chart accompanying the story, we mislabeled Jasper Wireless. The name of the company is now Jasper Technologies.

LETTERS TO THE EDITOR

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How Secure

Safe enough for investors, it seems. Despite the threat of ISIS and the spread of civil war, big companies are doubling down on the region.

BY ERIKA FRY AND VIVIENNE WALT

Saudi soldiers march during a military drill in Hafar al-Batin, near the border with Kuwait, in 2014.

Is the Middle East?

Closer Look

IN MID-MARCH—Friday the 13th, in fact—corporate VIPs from around the globe will descend upon Sharm el-Sheikh, a resort town on the Red Sea renowned for otherworldly scuba diving and soft, sandy beaches. By sheer demographics, the agenda would seem to have ready appeal: how to invest in an emerging market with some 90 million people. The weekend summit, billed "Egypt the Future," will be attended by the likes of General Electric CEO Jeffrey Immelt, World Bank president Jim Yong Kim, and British ad tycoon Sir Martin Sorrell. It's likely to be a hopeful, well-choreographed affair—the Egyptian government has said it will present 30 new projects, worth $20 billion—that aims to leave no doubt that after a rough few years the world's most populous Arab nation is back and safe for business.

PHOTOGRAPH BY FAISAL AL NASSER—REUTERS/CORBIS

A Starbucks in Kuwait's largest shopping mall

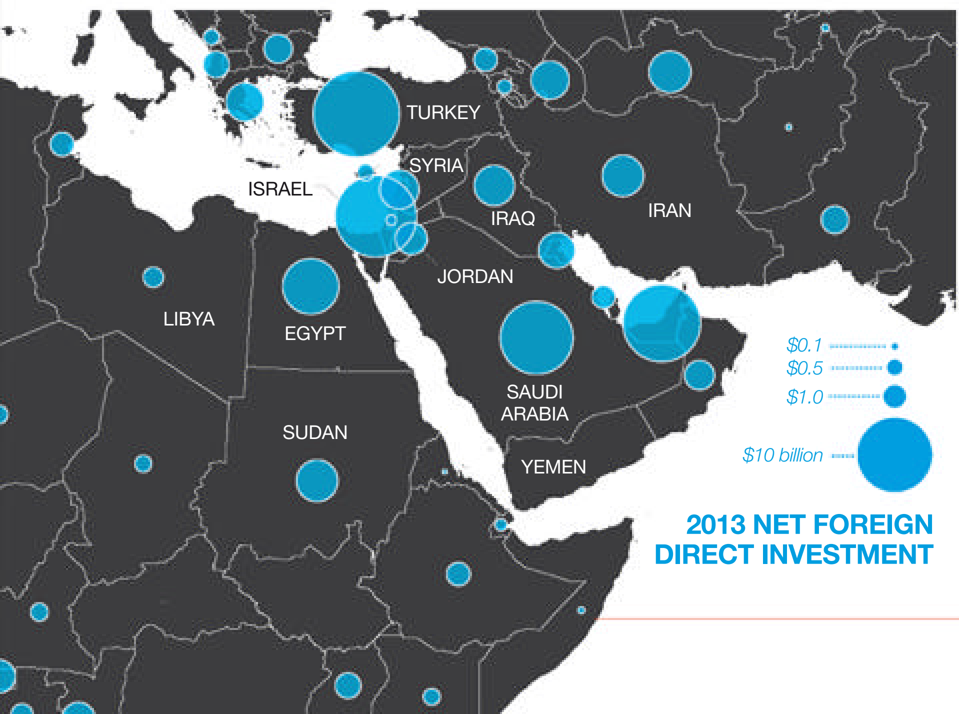
For years the Middle East, flush with petrodollars and home to a fast-growing class of youthful consumers, has been among the most promising markets for foreign investors—but recent turmoil has prompted many to ask whether the risks outweigh the potential profit. Nowhere is this calculus more muddled than in Egypt—where the government is fighting an increasingly violent Islamist insurgency on the Sinai Peninsula, a couple of hundred miles north of Sharm el-Sheikh.

Egypt's commercial center, Cairo, continues to suffer spasms of violence four years after the Arab Spring: Clashes at a soccer match in the capital recently killed more than 20. In January, on the four-year anniversary of the protests at Tahrir Square, a poet was shot dead by police on a busy, central street while laying flowers. And Egypt is one of the region's bright spots.

It's no secret that after a spectacularly bad 2014, the broader Middle East is reeling at all corners. Ongoing civil wars in Syria, Iraq, and Libya have been fueled by the swift rise and brutal terror of extremist groups such as ISIS. Yemen's government fell to rebels earlier this year, and Jordan, a small state burdened with refugees from Syria, Iraq, and elsewhere, has been dragged into an existential regional conflict. The Amman government stepped up attacks on ISIS in February after the group immolated a Jordanian pilot. Even the relatively stable Gulf states, long steadied by oil wealth and aged rulers, have been rocked by the plummeting price of crude and the death of Saudi King Abdullah bin Abdulaziz.

The flow of petroleum riches—used by many of the region's governments to raise salaries, pay subsidies, and otherwise keep people content—has slowed considerably (see our feature package in this issue).

The conditions haven't been easy on foreign business in the region. Oil companies have found themselves taking on more risk for less financial reward. In December, for instance, al Qaeda said it would target French energy firm Total, which has operations in Yemen and is one of the few multinationals to do business there. Mean-



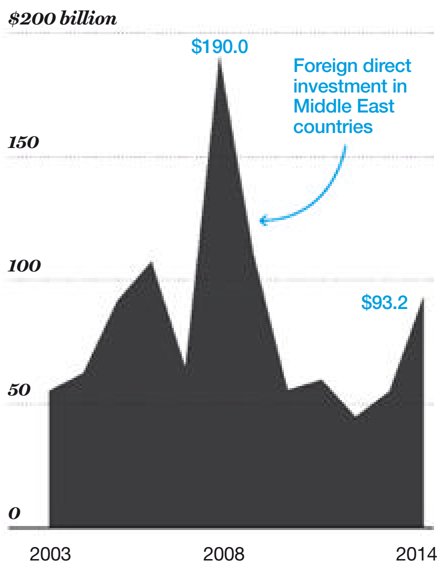


PHOTO: PETER DENCH—GETTY IMAGES REPORTAGE; GRAPHIC SOURCES: FDI INTELLIGENCE; UNITED NATIONS

GRAPHICS BY NICOLAS RAPP

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while, in Libya, where production has dropped from 1.8 million barrels a day in 2010 to 350,000 today, the situation has gotten only worse. “Oil facilities until last year were not in the line of danger,” says Geoff Porter, president of North African Risk Consulting. “But that is beginning to change.”

Danger notwithstanding, it’s hard to find businesses that are writing off the region. The swelling ranks of young people—the population between ages 15 and 30 is 100 million strong—makes the Middle East and North Africa especially attractive to consumer companies like Sony and Coca-Cola, which both name the region among their fastest-growing markets. (Coke is actually adding manufacturing capacity in Iraq and Gaza, among other locales.) Infrastructure projects are another draw: Bechtel has a $10 billion contract to build two metro lines in Riyadh. Many also consider the Middle East the new hub for global aviation and one of the hottest destinations for drugmakers.

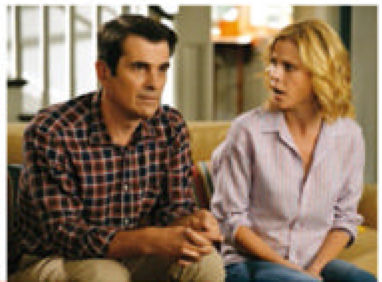
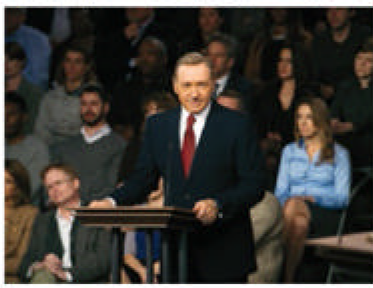
“The Gulf market is the centerpiece of our activities in the area,” says David Welch, president of Bechtel’s Europe, Africa, and Middle East region. “We are a project company. We will go where projects can be done and where there is the wherewithal to do them.”

And in many parts of the Middle East there remains plenty of wherewithal. Egypt, for one, has embarked on a $4 billion expansion of the Suez Canal, a three-year project the government is hustling to get done in one year because of “deteriorating security.”

Of course, even with such determined optimism, the new era of heightened volatility is forcing some nations to think differently when it comes to making their citizens (and foreign investors) feel safer. Take Saudi Arabia, which is employing a centuries-old tactic to this aim: building an airtight wall along its northern and southern borders. Easy, you say? The wall on the Iraq frontier will be 600 miles long.

China’s Censors Target Streaming

HUNDREDS OF MILLIONS OF CHINESE GET U.S. TV SHOWS ON THEIR COMPUTERS. THE GOVERNMENT IS WATCHING TOO. *By Scott Cendrowski*


Beijing’s regulators are not entertained.

COUNTERCLOCKWISE FROM UPPER LEFT CORNER: MONTY BRINTON—CBS; ERIC MCCANDLESS—ABC; FRANK OCKENFELS 3—AMC; DAVID GIESBRECHT—NETFLIX

China loves Sheldon Cooper. The fictional physicist who popularized the term “bazinga” is the star of CBS’s hit show *The Big Bang Theory,* which used to be the most popular Western broadcast on China’s many streaming sites. But he’s become increasingly hard to find.

In December, China’s State Administration of Press, Publication, Radio, Film, and Television (known, inelegantly, as SAPPRFT) announced that the days of unfettered online video were over. Internet video regulator Luo Jianhui said that streamed sitcoms and movies should be subject to the same oversight as traditional media. That means the removal of sex, violence, extramarital affairs, and basically anything else Chinese viewers like.

One of the government’s primary targets was clear: foreign shows. *House of Cards, The Walking Dead,* and *Downton Abbey* are some of the hottest online programs and represent a big potential market for the entertainment industry. But much of the content runs afoul of state rules, and predicting how they will be enforced is almost impossible.

The streaming censorship campaign started this past spring when the government told web portal Sohu.com and others to remove four

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> **"[TV producers] will have to deal with the demands of hypersensitive and paranoid censors."**
> —*Jeremy Goldkorn, director of media research firm Danwei*

American shows, including *The Big Bang Theory*. "Which is kind of weird," says Jiong Shao, who runs Macquarie's telecommunications, media, and technology banking unit in Hong Kong. As far as contraband goes, *The Big Bang Theory* is fairly inoffensive—particularly compared with *House of Cards*, which has some unflattering story lines about a corrupt Communist Party insider. But the show's sheer popularity might be threatening in itself, experts say. In mid-January of this year, the cleansing continued: U.S. shows including *Agent Carter*, *Empire*, and Showtime's *Shameless* were summarily banned.

The regulator's actions represent a sharp shift in China's relations with the American entertainment industry. Three years ago, it seemed, Beijing was starting to make nice with Hollywood, as pirated content was removed from the web. Western studios were soon raking in $100 million a year through licensing deals with streaming platforms like Youku Tudou, Tencent Video, and Sohu. Now some fear the rapprochement is over.

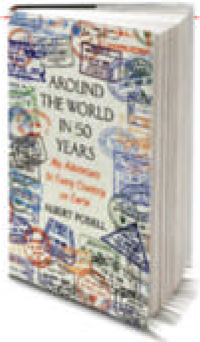
"It's going to be tough for foreign content in the coming years," says Jeremy Goldkorn, director of Danwei, a research firm in Beijing. The longtime China media watcher says there are clear signals from regulators that there will be even greater restrictions to come. "[TV producers] will have to deal with the demands of hypersensitive and paranoid censors, put up with popular shows suddenly being yanked from the Internet, and face pressure to censor content that is not even intended for Chinese audiences," says Goldkorn.

Adding to the frustration, the streaming sites had been a rare success story for Hollywood and China. Started as China's answer to YouTube, Youku transformed itself into a big spender, licensing everything from South Korean dramas to the ABC hit *Modern Family*. While the vast majority of Chinese users don't pay to watch ad-supported shows, the small segment that does is growing. According to Macquarie's Shao, just 0.1% of Youku users pay for premium subscriptions. That figure should increase to 5% for most sites over the next few years, he predicts, following the trend of other "freemium" sites, meaning the industry could reap $1 billion in profits.

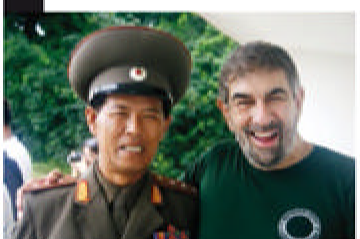
Three of China's homegrown tech giants—Baidu, Alibaba, and Tencent—have sunk big money into online streaming. Alibaba and its founder, Jack Ma, spent $1.2 billion last year for an 18% stake in Youku; Baidu runs iQiyi; and Tencent's video selection is growing rapidly: In November it inked a deal with HBO to stream shows. But if China's government continues slowing the role of Western studios in the sites' growth, it is likely to be a bad Hollywood ending on both sides of the Pacific.

CIRCUMNAVIGATIONS

ADVENTURES IN EVERY COUNTRY IN THE WORLD (AND THEN SOME)



Former lawyer and onetime *Playboy* editor Albert Podell, now 78, is one of a tiny group of travelers to have visited every country on the globe. He started in 1962 and has had to retrace his steps several times as the world map was redrawn. All told, the voyage took 18,513 days, cost a modest $300,000 (gas was 50¢ a gallon when he began), and filled seven passports with stamps. His new book, *Around the World in 50 Years: My Adventure to Every Country on Earth,* debuts in March. Here, his journey in numbers.



Podell poses with a North Korean soldier.

201
Countries visited, including several that no longer exist, such as the USSR and South Vietnam.

62
Continuous days without a hot shower or bath.

7
Near-death experiences, including a bout with giardiasis, a tiger-shark attack, and an attempted hanging in Pakistan.

5
Different kinds of antibiotics he carries in his medical kit.

14
Times robbed, mugged, or pickpocketed on his odyssey. (Six of those were in New York City.)

COURTESY OF ALBERT PODELL

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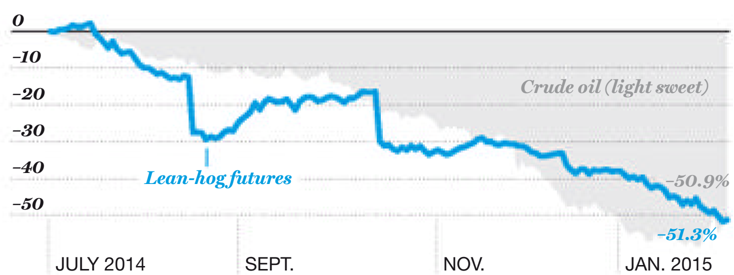
This Is the Only Commodity to Fall More Than Oil

Pity the pig farmer. Over the past seven months, since oil began its precipitous decline, lean hogs were the one major benchmark commodity to fall even further, according to the CME Group. The price of lean hogs—a term referring to butchered pigs regardless of paunch—has sunk 51.3% since the end of June. The drop follows record-high prices this past summer, after a disease called the porcine epidemic diarrhea virus whacked supplies. "The baby pigs were being wiped out at a rate that was never thought possible," says Phil Flynn, senior market analyst at the Price Futures Group. But the virus subsided surprisingly quickly, and more little piggies started making it to market. The USDA recently revised its projections to show 5.5% growth in pork production this year. Meanwhile, less American pork is being shipped overseas because of slowing international demand, driving a glut. "It's a perfect storm for pigs," says Steve Wagner, a market analyst for CHS Hedging. Wagner expects that lean-hog prices will linger at decade lows for a while. —*Jen Wieczner*

PRICES HEADING SOW: PORK TAKES A DIVE



THE DECLINE OF THE **APP MILLIONAIRE**

Smartphone apps are sucking up more of our time than ever (a 65% increase over the past two years), but we really use only a few of them. Facebook alone consumes 10% of our time, and most people don't download even one new app in an average month, ComScore reports.

That's bad news for aspiring app-reneurs. According to analytics firm Adjust, more than 80% of the 1.4 million apps in Apple's App Store are "zombies," meaning they can't be found on any of the company's thousands of top category rankings (and thus can't easily be found by users). Most will languish in obscurity. Getting rich quick: still no app for that. —*Erin Griffith*

NOTE TO ANTI-VAXXERS: BIG PHARMA ISN'T GETTING FAT OFF VACCINES

For drugmakers, treating diseases is far more lucrative than preventing them.

ANNUAL REVENUES FROM

Cancer drugs	*Diabetes drugs*	*Vaccines*
$67.1 BILLION	**$54.4** BILLION	**$14.1** BILLION

STOP WORRYING ABOUT THE COST OF **WINTER STORMS**

Sure, this year's record snowfall didn't do New England restaurants any favors, but unless bad weather lasts long enough to affect supply chains and inventory decisions, it won't take a huge toll on most cities' economies, says IHS economist Doug Handler—breathless media reports notwithstanding. For many, the shopping (and work) just gets delayed. —*Chris Matthews*

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Running Retirement U.

In a tumultuous financial world, **Roger Ferguson** must protect and grow the nest eggs of America's teachers. *By Geoff Colvin*

No one heard much about TIAA-CREF during the financial crisis, which was great news for Roger Ferguson. Just months earlier he had become CEO of the giant financial institution (No. 95 on the *Fortune* 500) that manages retirement investments for thousands of university professors and other employees of educational, medical, government, and cultural institutions. It came through the crisis fine and has since grown to almost $900 billion of assets under management. Ferguson, 63, was vice chairman of the Federal Reserve from 1999 to 2006. He talked recently with *Fortune* about crisis leadership, retirement misconceptions, and much else. Edited excerpts:

Where are you finding investment value now?
We still think there are opportunities in alternative investments—timber, agriculture, real estate, etc. In liquid investments, many people think small-cap companies are likely to have a bit of a run. A number of folks think Europe and perhaps even Asia, places that have been heavily beaten down, are subject to a rebound. But we try not to be market timers, so we follow a very disciplined, broadly diversified approach, and we recommend that to everybody.

Activist investors have been in the news. Have the Icahns and Einhorns of the world been good for shareholders?
It's too early to say. The reason is that in many cases they're interested in driving up equity valuations in a short period of time. There's another approach to active investing, which we follow, which is trying to work with management, develop a better strategy, and see that executed over time. That should produce much better returns, perhaps over a longer period and a little more sustainably.

Some researchers say the retirement crisis is overhyped. What's the truth?
The truth is we have a retirement challenge that could become a crisis if we don't address it. Social Security is totally capable of paying all its obligations now—but in the next 15 or 20 years, if we do nothing, Social Security will be able to pay only 75% of its obligations. It's not yet a crisis, but that puts a big premium on Social Security reform sooner rather than later.

What's the most unrealistic expectation that people have about retirement?
It's that their retirement is going to be like their grandfather's retirement. People don't realize that life expectancies have gone up, that we are healthier and therefore could have more active and longer retirements than they might imagine.

What's the most valuable thing you learned from leading TIAA-CREF through the financial crisis?
One is foresight. My team and I all had a sense that things were unraveling maybe more quickly than others had seen. The ability to look a little into the future is very important. The second thing is to communicate, communicate, and, did I say, communicate. Make sure people understand how you are seeing the world and why you're making the decisions you're making. That allows them to align their decision-making to your decision-making.

Ferguson (above) believes some activist investors are too focused on the short term.

COURTESY OF TIAA-CREF

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KPMG'S VIRAL MORALE MEME

WHEN THE ACCOUNTING FIRM ASKED EMPLOYEES TO SHARE WHY THEY LOVE THEIR JOB, IT DIDN'T EXPECT 40,000 RESPONSES. *By Robert Hackett*

As the stereotype goes, accountants are a species of professional often seen as spiritless human calculators—and not as indispensable visionaries. "'Taxes must be boring.' I get that all the time," says Kirt Bocox, senior tax manager at KPMG, one of the firm's many employees who dispute—indeed refute—that preconception. "People get the stereotype of accountants completely wrong. It's actually exciting and fun."

Bocox is not the only impassioned one. To hear Bruce Pfau, vice chairman of human resources and communications, tell it, the company, based in Amstelveen, the Netherlands, gushes with enthusiasm. So he devised a plan to harness that energy: Instead of dictating what employees *should* consider their motivating force, the company asked each to think up his own and frame it on a poster. HR provided a template on the organization's internal website, KPMG Today.

"I've always believed that culture is the most important dimension of any CEO's responsibility to an organization," says John Veihmeyer, global chairman and CEO of KPMG in the U.S., who kicked off the program in June with a video in which he stood on the Top of the Rock in New York City to announce a goal: the "10,000 stories challenge." If the company received that many posters by Thanksgiving, everyone would earn two extra days of paid vacation.

100 BEST COMPANIES TO WORK FOR
No. 80

COMPANY
KPMG

U.S. HEADQUARTERS
New York City

EMPLOYEES
162,000

PERK
A shared leave program allows employees to donate unused paid time off to co-workers who might need it in an emergency. Last year workers gave 10,000 hours.

Kirt Bocox at the KPMG office in Orlando

Posters rolled in by the thousands in the first week—"I advance science," "I promote peace," "We protect our nation." And they rolled in by the thousands during the second too. Even Phil Mickelson, the KPMG-sponsored pro golfer, joined in with one of his own: "I win titles." By July the company had blown well past the 10,000 mark—and submissions kept coming. By the time it ended in November, the company had received more than four times the requested number of posters.

"The initiative enormously exceeded our expectations, and morale scores soared to historic highs," says Pfau. In fact, in a recent engagement survey, the percentage of its U.S. employees who endorsed KPMG as a great place to work jumped to 85%. (The firm also had one of its most profitable years to date in its 118-year history.) "The higher-purpose focus of our firm, combined with its financial performance, makes me the proudest I've been in my time here," Pfau says.

Bocox, whose job includes helping farmers get loans, created an "I help farms grow" poster, which was featured on the company intranet. He says the program achieved a viral level within the company comparable to that of the ALS ice-bucket challenge that swept social media last summer. "It didn't cost a lot to do, but once it got going, it just took off," he says.

Bocox spent the extra time off with his brand-new baby daughter. She was born on the last day of December. "Pretty good tax planning," he often jokes while meeting clients. "If I'm willing to properly tax plan my child's birth, just think about what I can do for you."

CHRISTOPHER MCENIRY

To see Higher Purpose posters and learn more about perks at KPMG, go to fortune.com/bestcompanies.

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The rooftop pool at the Iberostar Parque Central hotel in Havana

Cuba Opens Up

The Tourists Are Coming

America is ready for Cuba. Are Cuban hotels ready for Americans?

By Anne VanderMey

COURTESY OF PARQUE CENTRAL

IMAGINE BOOKING a $4,000 weeklong vacation to an exotic locale near the ocean. Now imagine that when you get there, your room has no hand towels, the air conditioning is spotty, and it's illegal to kick back by the beach.

Welcome to Cuba, home to miles of white-sand beaches, premium tobacco, oak-aged rum—and 50 years of a business-phobic government under a crippling trade embargo. Thanks to new regulations the U.S. announced in January, which among other things will eliminate the need for a special travel license

GETTING THERE

to go there, the island nation has become the world's buzziest destination for Americans. It's also probably the only one that won't accept most credit cards.

Cuba has long been the forbidden fruit of the American tourist. A 30-minute flight from Florida, it already draws enough people from Canada and Europe to make it the Caribbean's third-most-popular destination, after Puerto Rico and the Dominican Republic. Cuba gets about 3 million visitors a year—just 90,000 of them from the U.S.

New rules have made travel to the country easier than it has been in half a century, and President Obama has said he wants more barriers to fall. In the Senate, Republican Jeff Flake of Arizona introduced a bill to end the embargo outright. If that happens, the IMF has said, the number of annual visitors to Cuba could easily double. Yet with a shortage of high-end accommodations, what Cuba will do with all of them is unclear.

Tour operators are already seeing a surge. Michael Zuccato of California-based Cuba Travel Services, which operates flights to Cuba and organizes tours for Americans, says he expects his business to increase 50% to 200% over the next several years. Michael Sykes, founder of Cuba Cultural Travel, has moved to secure some 10,000 rooms in anticipation of strong demand. Pam Hoffee, a VP at Swiss travel company Globus, predicts its Cuba travel business will triple. The main obstacle to all that expansion? Hotel space. Jennine Cohen, managing director for the Americas at high-end travel firm GeoEx, says it's rooms rather than demand that's limiting growth, a challenge that she expects will worsen in coming years as Cuba's weighty regulations hold up private development.

But, however slowly, development is coming. In downtown Havana, Swiss luxury brand Kempinski is in negotiations to build a 200-room resort that would be the country's most deluxe. Sebastiaan Berger, CEO of leading Cuba developer CEIBA Investments, says 10 to 15 hotels have a realistic shot at being built in the next few years. And there are signs of a more relaxed attitude toward new construction. About the same time the country released imprisoned British businessman Stephen Purvis from a Cuban jail after 16 months in custody on murky charges, it gave the green light to a new $350 million golf resort (the island has only three courses, and one of them is at Guantánamo Bay).

What really gets developers going is the possibility that the restrictions between the U.S. and Cuba could be eliminated entirely. Full normalization of trade relations would unleash a tourist deluge in the country, make construction far easier, and beckon the likes of Marriott, Hilton, and Coca-Cola, which have all expressed interest in investing on the island.

Until then, discerning travelers and their guides still have options. True luxury hotels on many itineraries include the Meliá Habana and the Meliá Cohíba, run by Spanish hotel company Meliá; the Iberostar Parque Central, also operated by a Spanish hotelier; the Hotel Saratoga, run by state-owned company Habaguanex; and the storied Hotel Nacional de Cuba, with stunning ocean views, though travel agents warn not to expect ultramodern amenities at the 85-year-old stalwart. Increasingly Cubans are also opening their homes to travelers, in bed and breakfasts called *casas particulares*; some can be wonderful, but quality varies, and it's difficult to arrive as a tour group.

What Cuba may lack in first-class amenities, it makes up for in culture, and the years before luxury development takes off may be the best time to go. "It's a trip for people really interested in active learning who want to be engaged all the time," Hoffee says. "If you want to sit on the beach and read a book, go to another island."

For CEIBA's Berger, it's a long-term play. The very adventurous will come see the Cuba unspoiled by capitalism and frozen in time: old cars, vintage streetscapes, and the faded glamour of a wayward egalitarian experiment. "With all its romance, the slippage of five-star services is being forgiven," Berger says. "That will last three or four years. Then Cuba will have to improve."

To travel to Cuba legally under the new regulations, Americans must fall into one of 12 categories. Some are concrete, like religious or business trips. Other categories are less clear, including "support for the Cuban people."

Most U.S. visitors travel under the education classification, using a subset that requires a full-time schedule of "people-to-people" activities. That typically means going with a tour agency that will coordinate city tours, talks with artists, and face time with locals. Packages for tourist activities like beach-going are explicitly forbidden. Travel may get easier soon, but in the meantime, these agencies can get you there and back.

• *Cuba Travel Services:* **Working on flights that will take off from JFK.** *cubatravelservices.com*

• *Marazul:* **A longtime major player in the country.** *marazul.com*

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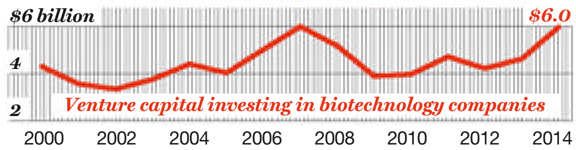
VENTURE

Bouncing Back
Overall, biotech venture funding is returning—but cash for early-stage companies still lags.



From left: Mark Levin, Robert Tepper, and Kevin Starr of Third Rock Ventures

Startups

Giving Birth to a New Generation of Biotechs

Third Rock is more than a venture capital firm. It actually creates companies. *By Jennifer Alsever*

GRAPHIC SOURCE: NATIONAL VENTURE CAPITAL ASSOCIATION

WHEN FOUNDATION MEDICINE, a young company that performs genetically targeted cancer tests, announced in January that Roche would buy a $1 billion stake, Foundation's stock price quickly doubled. Inside the Boston offices of Third Rock Ventures, the partners felt

PHOTOGRAPH BY **BRAD DECECCO**

Third Rock is "one of the few firms I've seen in 30 years that have reinvented the model of venture capital." *—Bill Helman, Greylock Partners*

the warm glow of parental pride.

Third Rock calls itself a venture capital firm, but it provides much more than funding and guidance for new enterprises. Third Rock hatched the idea for Foundation Medicine in 2008. Third Rock's team of 50 scientists and technologists designed the company's service. Third Rock drafted its business plan. The firm then infused the startup with $25 million and picked a CEO to launch it and usher it to an IPO.

Third Rock has taken this approach with nearly all of its 36 portfolio companies since its founding in 2007, and it has enjoyed other hits: Agios, which makes drugs to treat genetic disorders and cancer, and BlueBird Bio, which uses gene therapy to treat rare diseases, were among the top four biotech stocks in 2014, with 300% ascents.

Third Rock's strategy has been "brilliant," says VC Bill Helman of Greylock Partners. "They're one of the few firms I've seen in 30 years that have reinvented the model of venture capital."

The firm wouldn't exist were it not for a visit to the blackjack tables in Las Vegas. The story sounds like the setup to a cheesy joke: A finance executive and a biochemical engineer walk into a casino… In this case the two men, who had grown close while working to market the multiple-myeloma drug Velcade at Millennium Pharmaceuticals, were making their annual gambling pilgrimage in 2006. They commiserated over the drug industry and its loathed reputation for valuing profits over patients.

"The patients are getting screwed," Kevin Starr said. "We need to do something." Now 52, Starr is a finance executive who rides a motorcycle and favors skull rings. Next to him sat Mark Levin, now 62, a biochemical engineer who worked at Eli Lilly and Genentech before joining Millennium. They soon expanded the discussion to include Robert Tepper, 59, a former oncologist at Massachusetts General Hospital who headed R&D at Millennium.

After the three left the company, they explored new ideas. They toured academic research facilities and found what Starr calls "jaw-dropping innovation." But the ideas rarely progressed beyond scholarly journals. "We said, 'Why is this sitting here in academia?'" he says.

Money was the reason. Biotech had a hot run in the 1990s. But by the early 2000s the costs of taking a drug to market had grown prohibitive, the odds slim. VCs mostly focused on later-stage companies or fled biotech altogether.

Tepper, Starr, and Levin decided to create a firm that would conceive and build businesses from scratch. (The name was inspired by a news report that discussed the changes on Earth, the third rock from the sun—not by the TV show of that name.) The trio started hiring Ph.D.s and MDs from Harvard and MIT. Many VCs scoffed, the Third Rock partners say. But by 10 weeks in, the firm had raised its first fund, $378 million. To stay focused on patients, the firm instituted a quarterly practice of inviting them to come talk about living with a rare disease or cancer. "We always cry our eyes out and get fired up to go back to the office," Starr says.

Foundation Medicine was one of the first ideas to get traction. The concept was based on research by Eric Lander, a leader in the Human Genome Project and founder of the Broad Institute of MIT and Harvard. They wondered, what if they could sell a diagnostic test that uses DNA sequencing to help determine which cancer drugs could best fight a particular patient's tumor?

Third Rock invited Lander to weekly brainstorming sessions along with Alexis Borisy, then CEO of CombinatoRx, which uses software to match combinations of cancer drugs to treat certain tumor cells. They discussed how to scale up testing and make it affordable.

"It was going to be hard to do," says Borisy, who later joined Third Rock. A sequencing test then cost tens of thousands of dollars. They needed the price to sink to $2,000—and they needed to persuade insurers to pay for it. For 18 months, teams from Third Rock and the Broad Institute met with experts in gene sequencing and with diagnostic companies. They talked to pharma companies, met with cancer doctors and insurers, and worked with regulators. They built models for DNA testing. "It was group genius," says Borisy.

When Foundation finally launched in 2010, Third Rock backed it with $25 million. Google Ventures and Kleiner Perkins later kicked in too. The total, $40 million, far exceeded the typical $5 million to $8 million Series A biotech round. The goal: Allow the CEO to focus on growth rather than the next investor.

By 2012, Borisy decided it was time for Foundation to leave the nest. He hired a CEO, and over the next two years the company rolled out two DNA-based cancer tests, collaborated with cancer centers and drug companies, and landed a $56 million investment from Bill Gates and others. In September 2013, Foundation went public.

Third Rock won't disclose its returns. But according to the website of one of its investors, Calpers, its 2007 fund has generated an internal rate of return of 25.7%. That puts it well into the top performance quartile, according to alternative-investment tracker Preqin.

Meanwhile the hot IPO market, along with FDA efforts to accelerate approvals for breakthrough drugs, has helped rekindle VC interest in early-stage biotech. For Starr, the goal is to reach more cancer patients. "For us, these aren't investments," he says. "It's validation that our babies are coming into adolescence."

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EQUAL HOUSING LENDER

How to Get Over Yourself

A TOP PRESENTATION EXPERT OFFERS WAYS TO GALVANIZE YOUR SPEECH—IN PUBLIC AND IN MEETINGS.

Interview by Dinah Eng

It's no secret that public speaking strikes terror into many a heart. For some, even piping up at a meeting can induce anxiety. Bill Hoogterp, co-founder of Own the Room, has made it his goal to attack this scourge. Hoogterp, 52, began his career in the nonprofit world, and his sense of mission endures. His firm trains executives at companies like Facebook, Siemens, Visa, and Time Inc. (*Fortune*'s parent) in presentation and leadership skills—most of all, helping people to get out of their own way.

How do you get an audience to hang on your every word?
The best speakers focus on the audience, not themselves. The ego wants to protect itself in a spaceman's bubble, and the energy that's trapped inside creates nervousness. Instead of focusing on that queasy energy, flip it and focus on the audience. Involve the crowd with a question and get them engaged. For example, say, "Turn to the person next to you and say one word that captures your career so far." Everything should be about the audience and the content.

What makes a speech memorable?
The brain translates words into pictures and emotions. Emotion is the lasting part of memory, so build your talk around the emotions you want to evoke. The audience remembers what it feels more than what you say.

Should you rehearse?
When it comes to preparation, I'm a fan of having bullet points. Then it's about building an arc with stories and content. Involve the audience every few minutes or they'll tune you out. After making a point, pause for two to 2½ seconds to allow people time to process what you just said. Otherwise you'll undercut the power of what you're trying to convey.

What if a joke falls flat?
If you start with a joke, people might not laugh because they don't know you're trying to be funny. A comedian might say, "A funny thing happened to me on the way to the show," which sets up the joke. So try something similar. If the first joke falls flat, try again. Just say, "Tough crowd, tough crowd." You'll win them over. As with many things in life, most people give up too soon.

What's a typical problem?
People repeat things unnecessarily. Here's a game we do to change that. Mix half a cup of soda with half a cup of water. Every time you say "um," "let me add to what he said," or other phrases that mean nothing, you have to take a drink. If we get rid of weak language, 60-minute meetings can become 30 minutes. When your words become precise, people listen.

Sounds like you've certainly found your voice.
It's a rush helping a group learn, laugh, and get better quickly. There were people who told me that in the field of leadership development, speaking and presenting is too narrow of a niche, but I was not deterred.

The phrase "own the room" is not just about public speaking. It all ties back to the power of your personality. People have more greatness than they know. So give yourself permission to be brilliant. All of us are driving a Ferrari with the hand brake on. I love teaching how to let it out.

ILLUSTRATION BY MAREK HAIDUK

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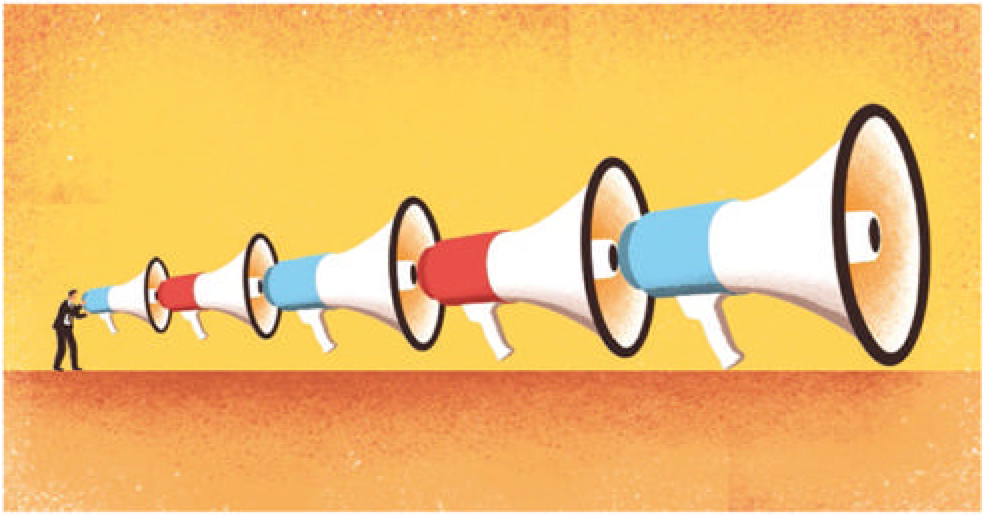
5 Ways to Get More From Your PR

EVERY COMPANY WANTS TO IMPROVE ITS MEDIA COVERAGE. HERE ARE SOME SMART WAYS TO DO THAT. *By Verne Harnish*



1 SKIP THE CANNED PRESS RELEASES

Nothing is more annoying to reporters—whether they're at newspapers, trade publications, TV operations, or websites—than getting pitches that don't reflect what they cover. "They're all completely different outlets with completely different readers," says Cameron Herold, who coaches CEOs around the world on public relations. "You need to spend the time to understand the journalists and who they write for." Explain exactly how your story fits into their coverage now—or don't hit "send."

2. STAFF IT

If you're serious about a professional media strategy, assign someone to handle the wholesale side of PR, such as researching journalists and customizing press releases. You don't have time for it as chief executive. At 27-employee startup TINYpulse in Seattle, CEO David Niu has hired two full-time publicists to do the work—and it has paid off. The company has been mentioned in the media about 100 times in 12 months. "You have to invest and commit to it, just like starting and ending your meetings on time," Niu says.

3. OWN THE RELATIONSHIP

The one part of PR you shouldn't hand off is the ultimate retail side: bonding with influential journalists. Send them an occasional note or meet them for lunch. "I don't delegate that," says John Ruhlin, founder of the Ruhlin Group, a six-person provider of corporate gifts in North Canton, Ohio. Thanks to this approach—and help from a content-marketing firm in raising his firm's profile—he says its name has been in the press more times in the past 18 months than in the 12 previous years.

4. DON'T BLOW IT

Commit to making key executives available—on the phone, not via email—when journalists call on deadline, or you may not hear from them again. When Herold ran public relations as chief operating officer for 1-800-GOT-JUNK?, he made sure that when reporters phoned to interview founder and CEO Brian Scudamore, his response was always, "Of course he's free. Let me go grab him." It made a difference. The company landed coverage in many national media outlets.

5. GIVE BACK IN A UNIQUE WAY

Plastic surgery and medical spa chain Beautologie's team was pleasantly surprised at how much media attention they got when they launched a pro bono tattoo-removal clinic. Local newspapers and TV stations loved hearing about how they helped more than 500 gang members and others turn their lives around. The staff found it meaningful too. "They feel they are involved in something bigger," says Beautologie owner Dr. Darshan Shah.

VERNE HARNISH IS THE CEO OF GAZELLES INC., AN EXECUTIVE EDUCATION FIRM.

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THE FUTURE IS A GAS

As the middle class expands globally and shale gas becomes plentiful, ExxonMobil is facing a bright future.

An ExxonMobil employee inspects polyethylene pellets, produced in Mont Belvieu, Texas; (Below) Innovative, five-layer film technology is a more sustainable solution for food and industrial packaging.

Neil Chapman, the new president of ExxonMobil Chemical, is upbeat: This business division of ExxonMobil is investing several billion dollars in new facilities in Baytown, Texas, that will increase its capacity to make the petrochemical building blocks of plastics. The expansion will create 10,000 construction jobs and add 350 high-paying permanent positions at ExxonMobil, the company says.

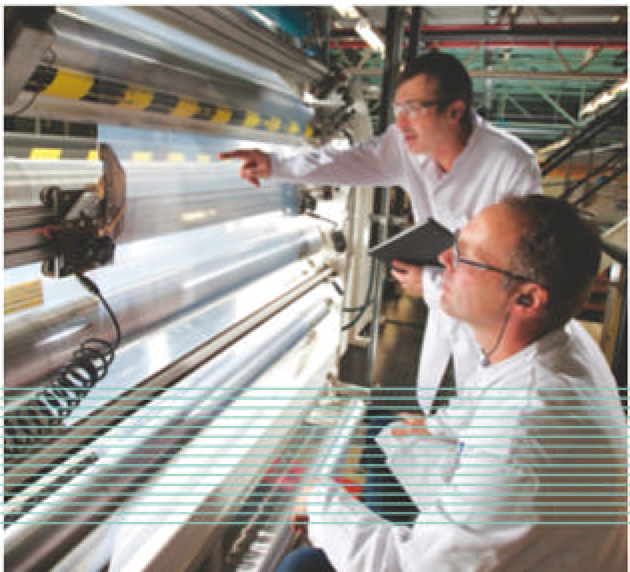
That is just the beginning of the petrochemicals story. Chapman puts it this way: "It's a renaissance of the U.S. chemical industry," as rising domestic shale gas production offers abundant, affordable supplies of energy and chemical feedstock. He estimates that chemical companies, including his own, are betting $100 billion on U.S. expansions.

The sharp growth of U.S. shale gas production is one reason for Chapman's optimism. The U.S. Energy Information Administration reports that domestic shale gas production soared from 2,116 billion cubic feet in 2008 to 11,413 billion cubic feet in 2013. This gives a boost to the chemical industry because natural gas liquids are ideal in the creation of plastics like polyethylene. "This results in very competitive production costs," says Chapman.

Another reason for Chapman's optimism is demand. ExxonMobil expects the world's thirst for chemicals to increase 50% in the next 10 years, driven by the emergence of middle-class consumers in developing countries. "By 2040, per capita GDP in China is expected to be four times higher than it is in 2010," says ExxonMobil's 2015-40 energy forecast. "It is likely going to be three times higher in India, and one to two times higher in key growth economies."

Chapman says ExxonMobil is making chemical investments for the long term because of confidence in the growth of this sector. "The majority of energy demand growth is in non-OECD countries. In chemicals, the vast majority of the growth is in those same countries. It's all about the middle class," he says. "Petrochemicals are so closely related to increases in the standard of living."

Products that seem commonplace to Americans take on new significance in emerging economies. A good example would be polyethylene film, the ubiquitous material that shrink-wraps fresh vegetables and beverage cartons alike. As people begin to shop in supermarkets and higher-quality stores, they come to expect fresh and sanitary products. Chapman says ExxonMobil Chemical has the edge in producing a polyethylene that makes thinner film, while retaining its properties. "The core of our advantage is the product," he says. "We're confident with our competitive position in this segment."



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The U.S. is a world leader in chemical production and exports, driving economic growth and delivering products that maintain and improve the quality of life. And the good news continues for our 100-year old industry. New supplies of natural gas from shale resources are fueling U.S. chemical industry expansions of output that will create new jobs and boost exports. And ExxonMobil plays a part as the largest U.S. oil and gas producer and integrated chemical company.

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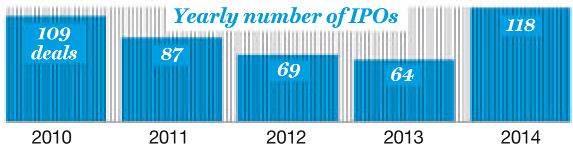
TECH

BOOMTOWN
By all measures, 2014 was a banner year for global tech IPOs.



GRAPHIC SOURCES: DEALOGIC; PWC

ILLUSTRATION BY NIGEL BUCHANAN

Rivals

A Tale of Two IPOs

Don't be fooled by the drama of first-day performance. What Facebook and Twitter did after the offering is what mattered more.
By Erin Griffith

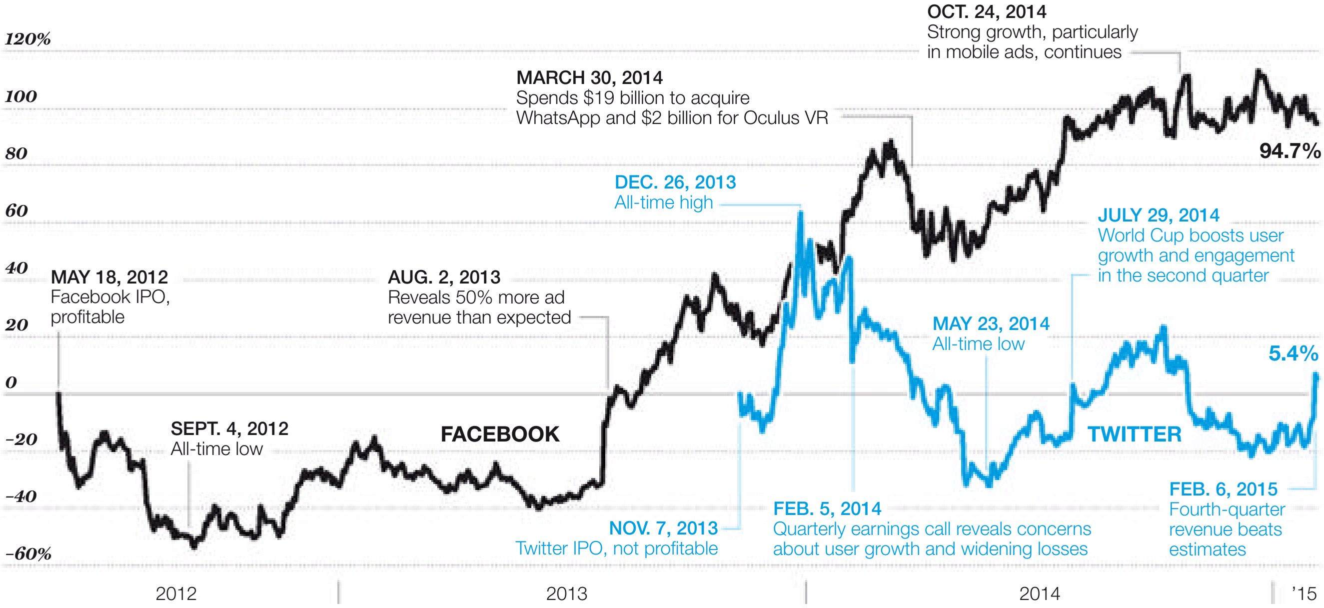
ANY WAY YOU look at it, Facebook's IPO was a flop.

A week before the May 2012 offering, General Motors yanked its $10 million budget, declaring that Facebook's ads didn't work. Investors fretted that the social media company wasn't making enough money from mobile ads. Regulators pressed the company on its mobile-revenue guidance, which proved controversial. On the big day, technical glitches at Nasdaq delayed the listing, creating mass confusion among traders. The stock closed at $38.23, up less than 1% from where it was priced.

The IPO of Twitter, Facebook's competitor for eyeballs and ad dollars, couldn't have been more

Two Roads, Diverged

THE OFTEN STORMY, SOMETIMES SURGING STOCK PERFORMANCE OF SOCIAL.



different. When Twitter went public in November 2013, the offering proceeded flawlessly, and its stock ended at $44.90, up 73%.

What happened next proves that for all the fuss over IPOs, they say very little about a company's value or its future stock price. After a rocky first year, Facebook's stock climbed precipitously, trading recently at $76. It earned almost $3 billion in profits last year. Its top executives, Mark Zuckerberg and Sheryl Sandberg, remain the toast of the technology industry. In contrast, Wall Street quickly soured on Twitter after its model IPO: Its shares, after rising 282% from its offering price, are back where they started. The investing commentariat has called for CEO Dick Costolo's head; CNBC's Jim Cramer said Twitter has an "ABC situation"—as in "Anybody but Costolo."

For investors, perception always has been as big a factor as fundamentals. But the inverse narratives of the Facebook and Twitter IPOs show that over time, performance talks and buzz fades.

Facebook did have a problem with its mobile business in 2012. At the time of its IPO, Facebook generated no meaningful revenue from its rapidly growing pool of mobile users. Today the company has fixed it convincingly: Mobile represented two-thirds of Facebook's $12.5 billion in revenue last year. An aggressive turnaround was more meaningful to investors than the technical failings of the exchange on which it chose to trade its shares.

Twitter's IPO may have gone smoothly, but problems began to pile up soon afterward. Despite rapidly accelerating revenue, the rate that Twitter added monthly active users slowed—less than 4%, to 241 million, in its first quarter as a public company, and as low as 1.4% in a recent quarter—worrying investors that Twitter might not be the mainstream product that its soaring valuation promised. (Just 36% of Twitter users access it daily, according to Pew, well below the 70% for Facebook.) The departure of top executives in 2014—COO Ali Rowghani, CFO Mike Gupta, and several vice presidents—further spooked investors.

Worst of all, Twitter has failed to clearly define what it is. "I've heard Dick Costolo use characterizations that were anywhere from a town square to a series of concentric circles," says Scott Kessler, an analyst with S&P Capital IQ. "There's confusion inside and outside of the company on whether it's a tech or media company." Much like turnaround-mode Yahoo.

Twitter may finally be pulling itself together. Its latest quarterly results, reported in February, included higher-than-expected revenue, shrinking losses, a spate of product launches, intriguing new partnerships, and a plan to monetize "logged-out" users—people who engage with Twitter content elsewhere online. Wall Street responded positively, rewarding Twitter with one of the biggest single-day gains its stock price has ever experienced.

It's the kind of buzz that Costolo and company can probably get behind.

GRAPHIC SOURCE: S&P CAPITAL IQ


A STAR ALLIANCE MEMBER
Tight deadlines.
Hard day.
Soft landing.
Air travel engineered around you
Nonstop you
Make your time with us all yours. Because we engineer your travel experience to be exactly what you need it to be – from the last checked email to your first taste of relaxation. Lufthansa wants you to sit back and enjoy your trip even before you arrive at your destination.
Lufthansa
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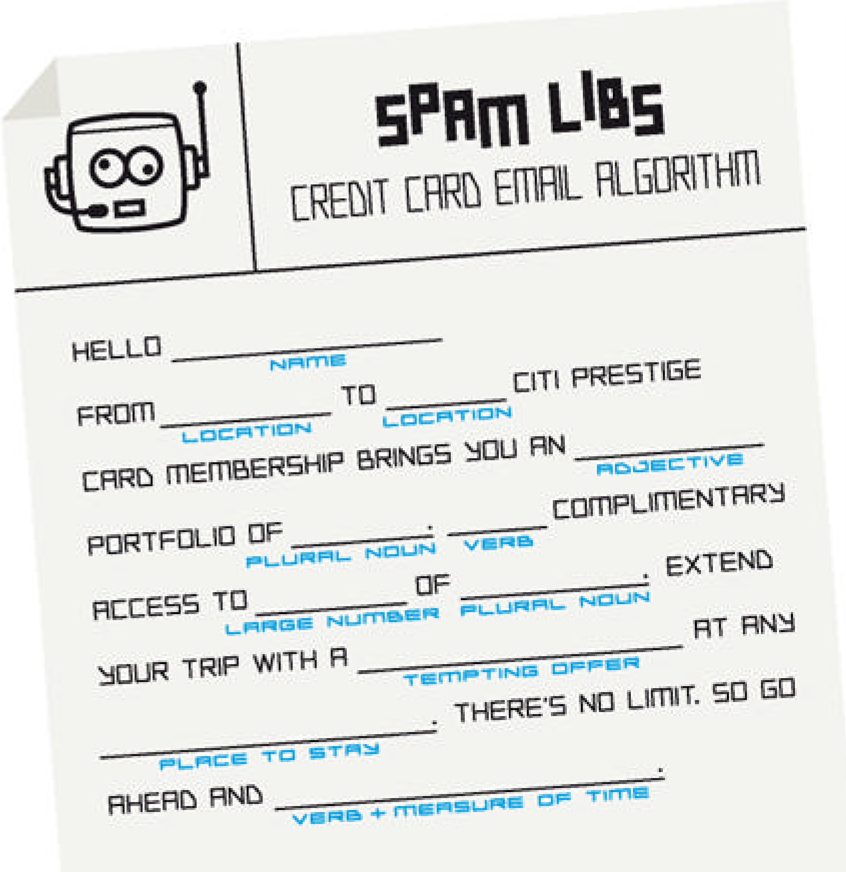


I, Robot Marketer

WITH MACHINE-LEARNING SMARTS, **CITI** ENSURES THAT ITS EMAIL PROMOTIONS LEAVE NO NOUN OR VERB UNTURNED.

By Robert Hackett

In the annals of marketing, no anti-littering slogan has ever held more swagger or sway than "Don't mess with Texas." Appealing to an audience's emotions works: In the decade or so after that campaign appeared, stray trash plummeted statewide.

Now imagine if salesmen had that power of persuasion—or better yet, robot salesmen. That's the kind of manipulative mastery Citibank is employing in its marketing departments in an attempt to boost the success of its promotional emails.

Citi's marketing missives use natural-language processing—a blend of artificial intelligence and linguistics—to generate sentences and phrases that customers can't help clicking. The idea is to trigger an emotional response (and index-finger twitch) that might translate into sales. "It eliminates the guesswork of copywriting," says Alex Vratskides, CEO of Persado, the startup behind the tech.

Three-year-old Persado says it has distilled the spectrum of human emotion into 19 categories—such as gratitude, fear, and love—all for the purpose of calling customers to action. The company says it has tens of millions of ways of phrasing email subject lines and has identified, for instance, 250 different ways to say "Call now." By generating all possible word combinations in a given semantic space and testing a subset, it's able to deploy the one that best rouses a response. The dispatches, though coolly calculated, tug consumers at their core.

"It's like generating the most beautiful woman from the best possible genes," says Vratskides, grinning. "Think of these as genetically engineered marketing messages."

Citi, for one, has lots of reasons for employing machine-learning technology in its communications: to sell credit cards, to persuade customers to upgrade or open new checking accounts, to coax people into spending rewards points. If it's going to contact customers anyway, why not tailor the messages to be as engaging as possible?

Persado says Citi has seen a 70% increase in the "open rate" of its emails and a 114% increase for the "click-through rate" within them. (Though Citi acknowledged that it uses the technology, it declined further comment.) The bank seems to have had such success with the software that Citi Ventures, its investment arm, participated in Persado's second round of funding along with American Express Ventures and Bain Capital Ventures. It totaled $21 million.

And what would robo-marketers make of "Don't mess with Texas"? David Atlas, a Persado marketer, can't resist a rhyme: "We call this persuasion automation."

COMPANY SNAPSHOT

NAME
Citigroup

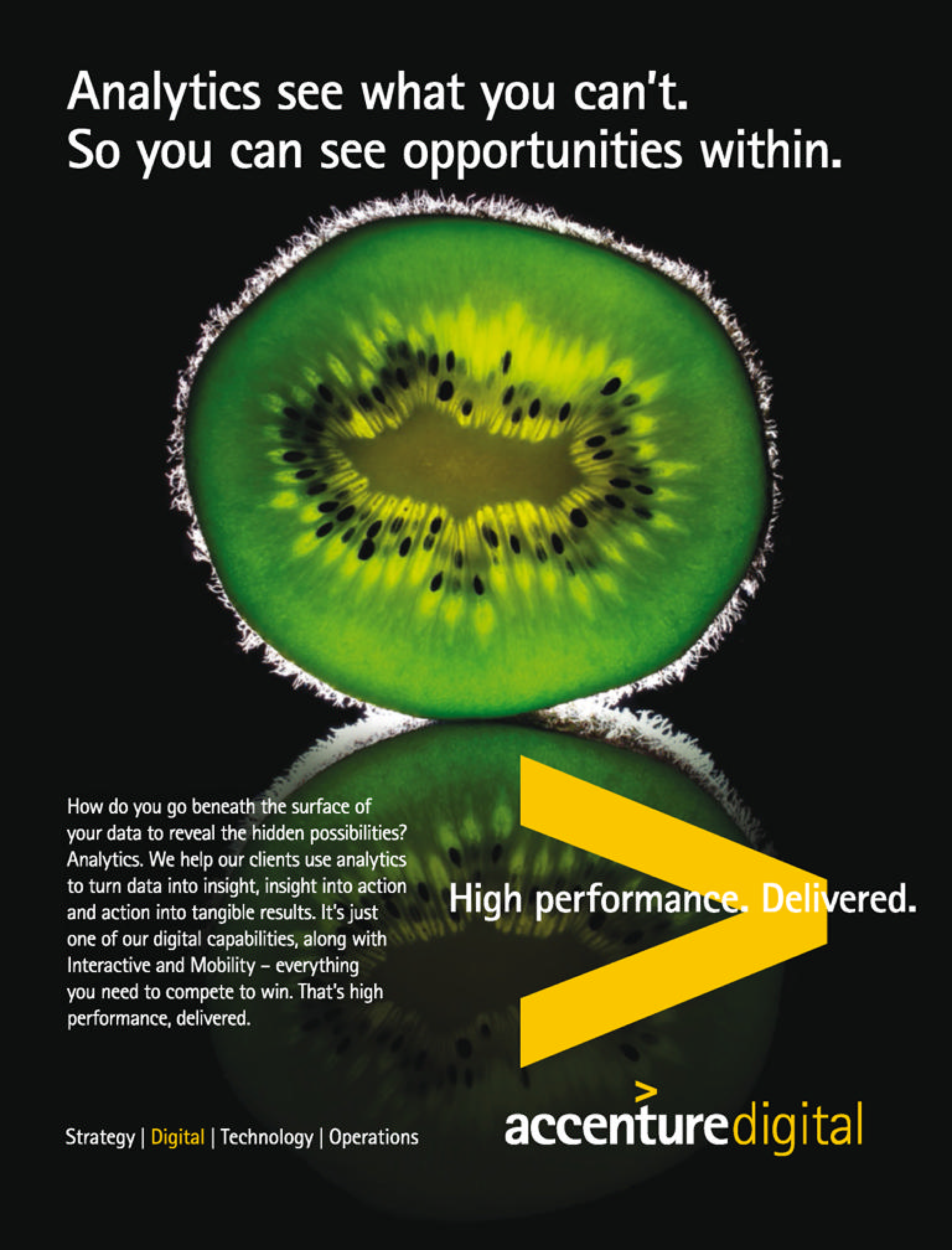
RANKING
26

HEADQUARTERS
New York City

EMPLOYEES
251,000

REVENUE
$90.57 billion

ILLUSTRATION BY L-DOPA



Analytics see what you can't.
So you can see opportunities within.
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High performance. Delivered.
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COMPANY SPOTLIGHT

CIGNA

CIGNA'S COMMITMENT TO HEALTHY LIFESTYLES BEGINS AT WORK

DAVID M. CORDANI
President and CEO

"An emphasis on prevention has helped the company maintain its own vigorous health."

Cigna, a leading health service provider, takes affordability seriously. And that starts with engaging employees and physicians.

THE COMPANY isn't content with just reimbursing sick-care claims. The Bloomfield, CT-based global health service company also provides millions of people with the information, support tools, services and incentives to improve their health, productivity and costs.

"A sustainable health care system begins with individuals making healthy lifestyle and behavior decisions," says Cigna Corp. President and CEO David M. Cordani.

This approach is helping Cigna customers get well, and stay well, and the result is fueling the company's global growth. Last year, the company served people in 30 countries, and its annual revenues grew to $35 billion. Cordani says he expects to see that figure double to $70 billion in the next seven to eight years.

Cigna has become a champion for the prevention of chronic disease, which is the leading cause of death and disability in the United States. Chronic conditions, such as diabetes and heart disease, are driven largely by rising obesity levels and are behind 75% of total health care spending.

A recent Cigna survey showed that U.S. consumers believe health costs could have a major impact on their ability to finance vital future needs. Cost was also the number one reason cited for not going to the doctor. Cigna continues to drive innovative solutions for the benefit of its customers, which in turn enables greater choice, transparency and affordability.

As a result, Cigna has been successful in helping to lower rising health care costs, which in turn has helped keep deductibles and premiums in check. For example, Cigna has among the industry's most favorable medical cost trends.

What factors will be key in holding the line for the future? Collaborative relationships with physicians and engaging customers through personalized care, says Cordani. In 2014, for example, Cigna saw about 28 million customer visits to its myCigna website, where customers can locate and compare doctors for quality and cost efficiency and compare pricing for procedures such as MRIs and mammograms.

"With localized health care, an activated consumer, and the right information, we are seeing positive change," says Cordani. "And that's a tribute to the commitment of our clients, customers, employees and our partners in the health care community."

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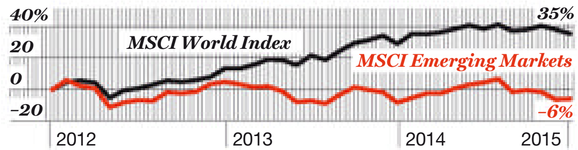
Great Divide
Emerging markets have lagged recently compared with stocks in the developed world.



Mobius, shown in Frankfurt, oversees $41 billion in investments at Franklin Templeton.

MOBIUS: OLIVER RUETHER/LAIF/REDUX; CHART SOURCE: BLOOMBERG

Embracing Risk in a Volatile World

For veteran emerging-markets investor **Mark Mobius**, fear means opportunity. ***By Stephen Gandel***

U.S. INVESTORS who have ventured overseas lately have not been rewarded. China is slowing. Brazil is buckling from lower commodity prices. The eurozone could crack. And Russia, starting last year with the conflict with Ukraine, has been

"Even in Russia, every time the political environment changes, you can make a hell of a lot of money buying in at a low price." *—Mark Mobius*

in a downward spiral for months that falling oil has only worsened.

For Mark Mobius, this spells opportunity. Mobius, who oversees $41 billion as executive chairman of Franklin Templeton's emerging-markets group, says there are always concerns with investing overseas. He should know. Mobius, 78, has been hunting undervalued investments around the globe for decades, and, if anything, he thinks things are more stable now than in the past. Calling from São Paulo after a stop in Singapore, Mobius spoke to *Fortune* about why and where he is finding opportunity in some of the places that make investors most fearful right now. Edited excerpts:

You recently tweeted a chart showing that stocks in emerging markets are roughly 40% cheaper than those in developed markets. But aren't they also much riskier?
It depends on what countries you are talking about. Brazil seems to have a lot of risk. But then you have places like India and China that are doing quite well. And even in Russia, each and every time the political environment changes, you can make a hell of a lot of money buying in at a low price.

But with the U.S. economy improving, does it make sense for investors to be venturing overseas?
When we started investing in Brazil, hyperinflation was running at 2,000%. Now it's in the single digits. There are always problems. But the reason you are seeing more negative headlines is that transparency is increasing dramatically because of the Internet and cellphones. This is forcing political change and reform, which is a positive.

In December you said you were bullish on China and oil companies. Neither bet has performed well since. Bad call?
Not really. Given how much oil prices have fallen, the diversified oil companies, like **Petrobras** in Brazil or China's **CNOOC,** haven't really been hit that badly. The exploration and production side of their business is only one part of what they do. And they are paying good dividends, which we expect to continue. In some ways lower oil prices are helping these companies. Petrobras, for example, used to have to import oil at a loss in order to meet government subsidy requirements. Now with the decline in prices, it doesn't have to do that. So while international oil prices are falling, prices at the pump in Brazil are actually going up.

But won't lower oil prices hurt those companies over time?
I think oil prices will come back up. Demand globally is not going down. You've got a billion people in China and a billion people in India who are getting wealthier and buying cars and motorcycles and flying places. They need oil.

Are you still bullish on China, despite the slowdown there?
If you look at the big picture, per capita income continues to rise, and housing sales continue to rise. Growth is coming down, but it's a bigger economy, where smaller percentage changes in dollar terms have bigger impact. There is no question that there are ghost cities in China. But there's still a tremendous shortage of quality housing. The problem is that a lot of the developers were building prospectively, and they were building high-priced housing. That's changing now. They're waking up to the reality that they need more affordable housing, and the speculators are not as active as they were in the past.

The U.S. economy is strengthening. Do you like U.S. stocks?
Unfortunately a lot of them have run up too much. We are looking at companies that are exposed to emerging markets. In Europe, **Unilever** is a company we like because over 50% of its sales are in emerging markets.

Any specific countries you think are a better bet than others in emerging markets right now?
South Korea is interesting. The dominance of the big conglomerates is weakening. The government is doing its best to support the small- and mid-cap sector, and that is having a positive impact on the economy. Besides that, there is a lot of technology in Korea that's been developed over the years that is paying off. And of course the proximity to China and the market penetration in China of Korean companies are really helping them as well. We like **AmorePacific,** which is the largest cosmetics company in South Korea.

And you're bullish on Russia too?
There's no question that Russian stocks are quite cheap. Many of the companies are very well run and have excellent management. We hold energy companies **Lukoil** and **Gazprom,** and **Sberbank,** which is the biggest bank in Russia. They have issues. For instance, Sberbank is owned by the government and may be forced to make policy loans. Same thing with Gazprom, which is sometimes used as an instrument on the policy front. But Russia's companies are generally run like commercial organizations. The problem is many of our funds are based in the U.S. If the sanctions are increased, you may have a situation where you can't get out. So we are still there, but it's very tough to add right now.

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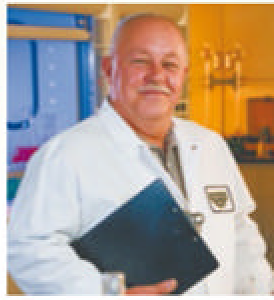

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STEM in Action

At James Campbell High School in Ewa Beach, Hawaii, students designed and built small desk-mounted fans that can be powered by salt water, helping to keep their fellow students cool.

Students from 50 states and the District of Columbia are demonstrating how their Samsung Solve for Tomorrow projects can help improve their communities.

TAKE MIDDLE AND HIGH SCHOOL STUDENTS, ask them to solve a problem that exists in their community, and then step back to watch what happens. Using STEM—science, technology, engineering, and math—students in schools across the country are proving firsthand that they have the creativity, discipline, and dogged determination to solve some of the thorniest problems facing our nation today. In the process, they are witnessing how lessons learned in the classroom can come to life in the real world and improve the lives of those around them.

Rising to the Top

The students putting their STEM skills to the test are participants in the Samsung Solve for Tomorrow Contest. The competition challenges U.S. public school teachers and students in grades 6–12 to apply STEM to address an issue that affects their local community. By showing the students how much of an impact STEM can make, Samsung hopes to create a lifelong interest in science and math, and, along the way, give birth to another generation of technology talent in the workforce.

The state winners' STEM projects, four of which are featured here, address a broad spectrum of environmental, social, and conservation issues, all of which demand fresh thinking and innovative solutions. "These are current, real-world problems that are being addressed," says Steve Lorenz, a teacher at Hudson's Bay High School in Washington state. "The kids come in every day and are energized about finding the answers."

Looking to the Ocean

Sam Tritto, a freshman math teacher at James Campbell High School in Ewa Beach, Hawaii, says his students appreciate the beauty of their surroundings—but not the heat. "There are days during the school year when it's 100° F inside the classroom," he says. "It's tough to learn in that kind of heat and tough to teach."

As the state evaluates plans to install solar-powered air conditioners in all classrooms, Tritto and his students are exploring another path: saltwater. "We're so close to the ocean, and saltwater is Hawaii's most abundant natural resource," he says. The students are learning how to harness the energy from the saltwater to power a small desk-

In Cherry Plain, N.Y., Berlin High School students used their skills to create a prototype of a wearable device for young children that alerts parents if kids wander too close to the road.

mounted fan. In the process, they're learning how natural resources can meet some, if not all, of the energy demand in their community. "This contest is really opening their eyes to all the different ways that STEM can make a difference," Tritto adds.

Keeping Kids Safe

Many of the houses in the rural community of Cherry Plain, N.Y. are situated close to the road, without fences or bushes to separate them from automobile traffic. The proximity to passing cars can put young children in harm's way if they wander too close to the road, says Dawn Wetmore, a teacher at Berlin High School.

To reduce the risk, her students designed a wearable device that sounds a signal if the child gets too close to traffic. "We wanted to make the buzzer loud enough for the parent to hear," says Wetmore. A beacon set on the homeowner's front lawn is also part of the program, alerting approaching drivers that a child is nearby and urging them to slow down.

Wetmore says the students working on the project tackled a host of engineering and electrical hurdles while creating the prototype. "I'm convinced that the kids learn more when the process doesn't work than when it does," she says. "They have to try different solutions, just like in the real world."

Unique Approach to Recycling

The school district where Hudson's Bay High is located, in Vancouver, Wash., spends more than $158,000 a year on paper waste removal. Teacher Lorenz and his students figured out that something as simple as mushrooms could give them a better, more economical way. The paper is mycoremediated, meaning that a paste of mushroom mycelia is spread on layers of the paper waste. In about 45 days, the mycelia essentially "eat" the cardboard and pearl oyster mushrooms begin to grow.

Not only does the district save money on paper removal, says Lorenz, but its culinary arts students can also use the mushrooms that pop up as an ingredient in high-protein veggie burgers. The hope is that the district can sell the burgers to local food vendors and create an additional revenue source for the schools.

Mobility for Special-Needs Children

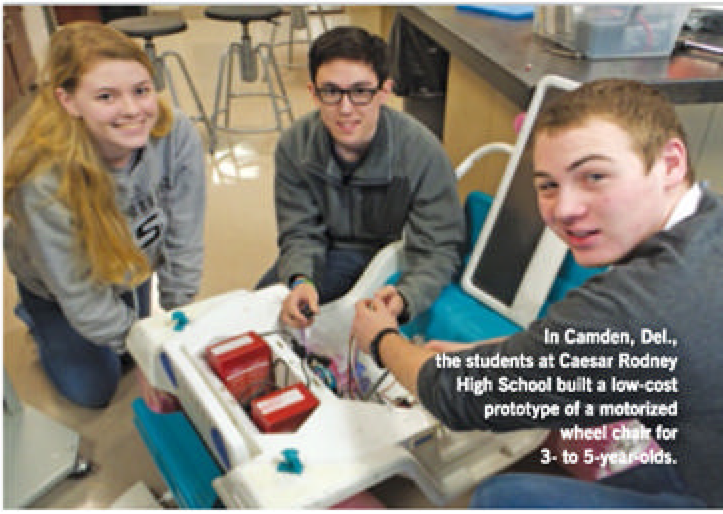
Young children with little or no lower-body mobility due to cerebral palsy often outgrow an expensive motorized wheelchair faster than their parents can afford to purchase a new one. The engineering students at Caesar Rodney High School in Camden, Del. are figuring out a solution to this challenge.

Using a modified children's Power Wheels car, the

Students at Hudson's Bay High School in Vancouver, Wash., used paper waste in the school district to grow mushrooms that can then be sold.

PHOTO: BOB BYRD

students are reverse-engineering the electrical and mechanical design, then redesigning the car so that younger children can control its movement with their hands rather than by using foot pedals. Technology teacher Timothy Elmer says his students are witnessing firsthand the difference their work can make in the lives of these young wheelchair-bound children: "There's such a sense of accomplishment for the students to know that they're helping to meet this real need in our community."



In Camden, Del., the students at Caesar Rodney High School built a low-cost prototype of a motorized wheel chair for 3- to 5-year-olds.

BIG TECH IS ON SALE

SOME OF THE BEST BARGAINS IN THE MARKET NOW ARE THE STOCKS OF BRAND-NAME TECHNOLOGY COMPANIES. *By Janice Revell*

Big-cap technology stocks have traditionally been prime beneficiaries of a strengthening economy. This time around is no different: The S&P 500 information technology sector returned 22% over the 12 months through early February, vs. a 17% gain for the broader S&P 500. The good news is that large tech stocks still have room to run, say experts, thanks to strong growth prospects and hefty cash stockpiles, which they can continue to deploy to their—and their investors'—advantage.

In a relative sense, mega-cap tech looks downright cheap at the moment. The price/earnings ratio for the S&P 500 information technology sector—using estimated 2015 operating earnings—was recently 15.9, compared with 16.2 for the overall S&P 500, according to S&P Capital IQ, which recommends overweighting large-cap tech stocks. Meanwhile, tech sector earnings are forecast to grow by 11.2% in 2015, well in excess of the 8.8% rate projected for the overall S&P 500. What's more, big tech companies are collectively sitting on mountains of cash—Apple, Microsoft, Google, and Cisco alone account for about 20% of total U.S. corporate cash holdings—leaving them plenty of leeway to hike dividends and extend share-repurchase programs.

Many analysts believe that the most attractive opportunities in tech lie with old-guard companies that have been punished by declining PC sales but are actively repositioning their businesses. At **Microsoft,** for instance, revenues from cloud computing more than doubled in the past quarter. Credit Suisse analyst Philip Winslow believes that Microsoft's new initiatives can return it to double-digit earnings-per-share growth. Winslow believes the stock could climb to $55 over the next year, from a recent price of around $42. It also pays a robust 2.9% dividend yield.

Intel, the world's largest chipmaker, has invested heavily in producing microprocessors for mobile devices. And the company projects that revenue from its high-margin data center group—which currently represents about one-quarter of its sales—will grow by 15% a year through 2018. "To say the data center group is a hidden gem is an understatement," contends Jefferies analyst Mark Lipacis, who thinks Intel could jump from $34 a share to $50 this year.

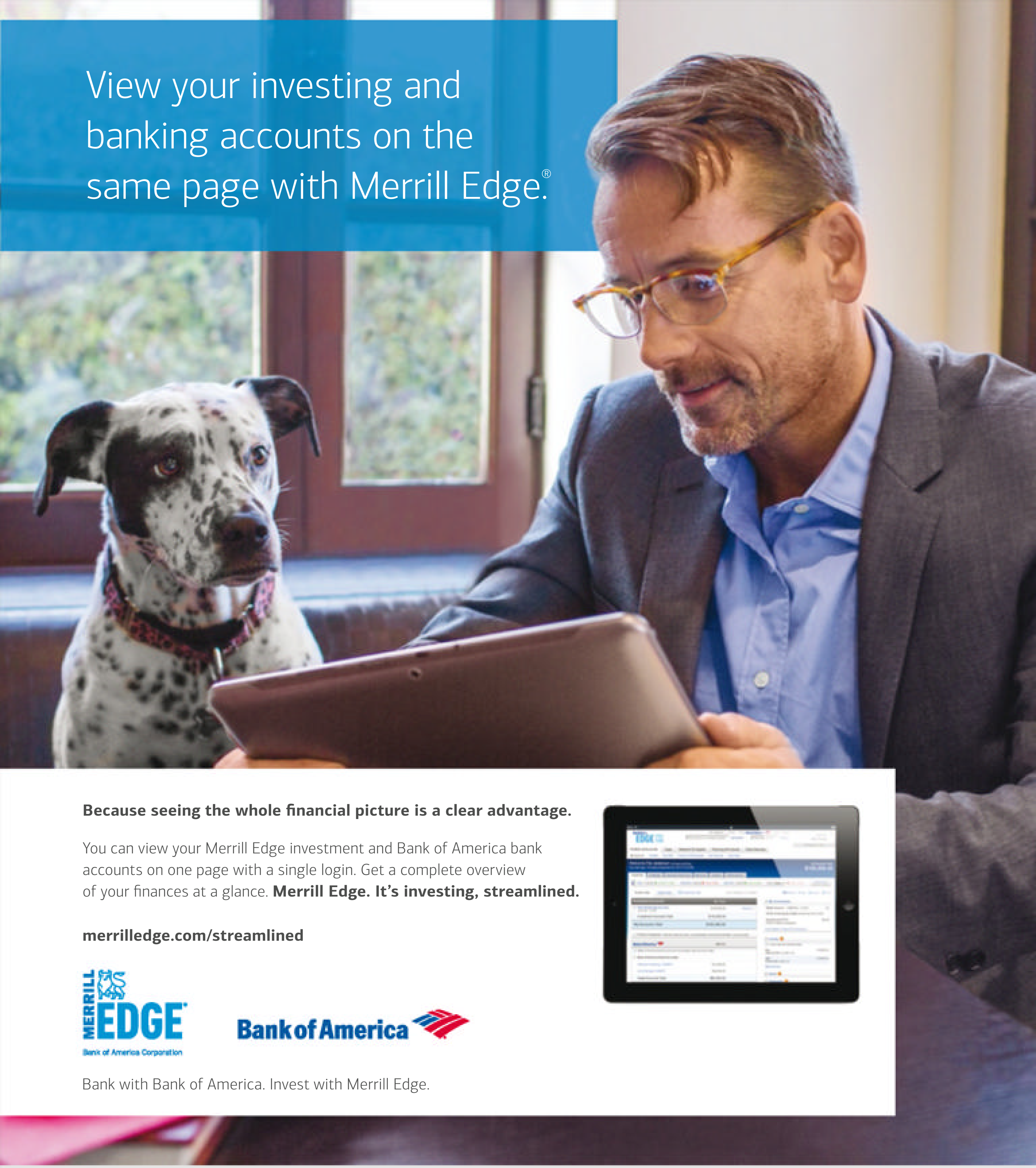
Google has aggressively invested in its Android operating system, which drives the vast majority of smartphones. The search giant's largest source of revenue, advertising sales, rose by about 17% in 2014. J.P. Morgan analyst Doug Anmuth notes that Google is one of the few companies in the S&P 500 projected to grow both revenues and earnings at a 15% to 20% rate over the next three years and "will remain a primary beneficiary of the secular shift to online spending."

Investors can also gain diverse exposure to large-cap tech through the **Technology Select Sector SPDR,** an ETF that tracks the tech sector of the S&P 500. The fund, which has a 0.15% expense ratio, holds 71 companies with an average market cap of $129 billion. Over time, Big Tech really may be beautiful. ■

A former compensation consultant, Janice Revell has been writing about personal finance since 2000.

PORTRAIT BY JOHN WILSON

ILLUSTRATION BY FRANCESCO BONGIORNI



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COMPANY SPOTLIGHT

HENRY SCHEIN

HENRY SCHEIN, INC.: FROM NEIGHBORHOOD PHARMACY TO MORE THAN 1 MILLION HEALTH CARE PRACTITIONERS

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STANLEY M. BERGMAN
CHAIRMAN OF THE BOARD AND CEO

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"We provide products and related services that any dentist, physician, or veterinarian around the world needs to provide exceptional care to their patients," says Stanley M. Bergman, chairman of the board and CEO.

Things have changed since the first shop in Queens – for one thing, the company headquarters moved down the expressway to Long Island. In the late 1940s, Henry Schein brought in $175,000 per year in sales. Last year, the company posted an impressive $10.4 billion in sales.

The company, however, is much more than a supplier. It is a partner for health care providers around the world who rely on Henry Schein for expert advice: how to operate their practices more efficiently, stay technologically relevant, and integrate innovative solutions that will enable practitioners to provide better clinical care in an office-based setting. As health care evolves globally, the company is a beacon for health care practitioners looking for guidance and best practices.

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The neighborhood pharmacy feeling has never left.

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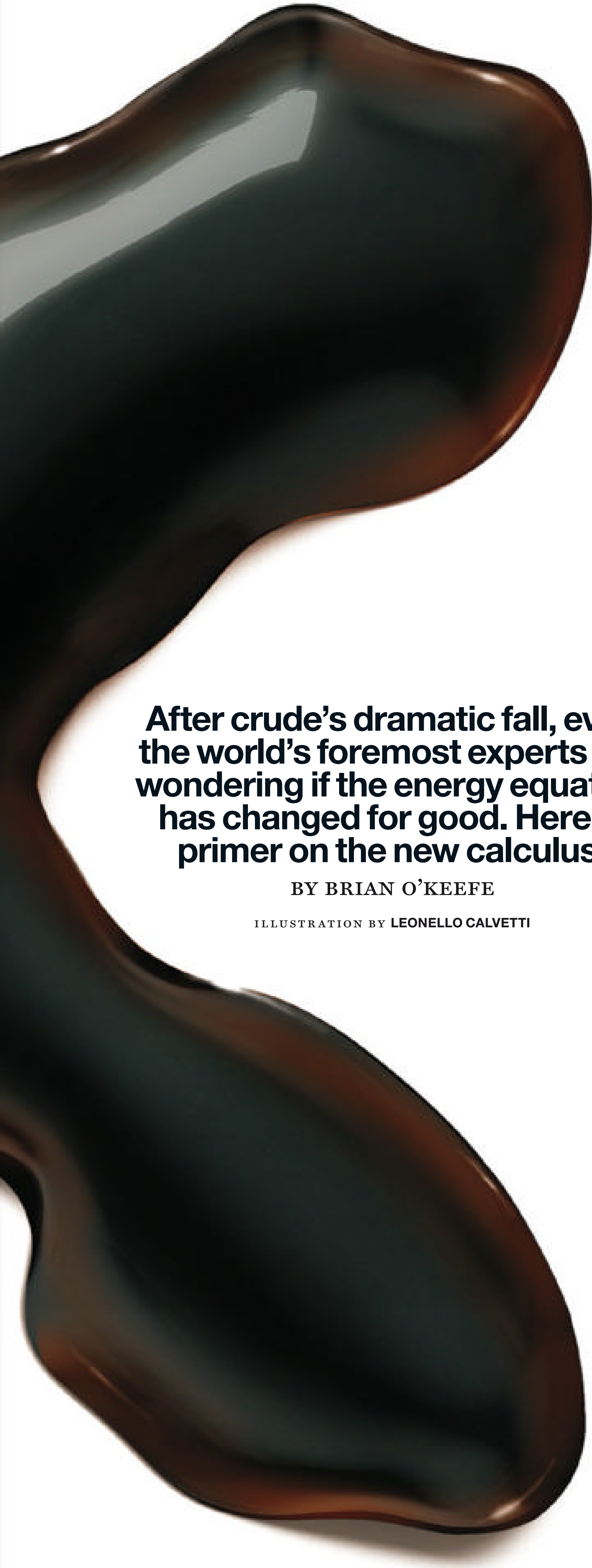
Oil's New Math



After crude's dramatic fall, even the world's foremost experts are wondering if the energy equation has changed for good. Here, a primer on the new calculus.

BY BRIAN O'KEEFE

ILLUSTRATION BY **LEONELLO CALVETTI**

JONATHAN GOLDBERG WAS ONE OF THE FEW who saw it coming. Early in 2014 the rookie hedge fund manager noticed something unusual: The amount of crude oil being stockpiled around the world was building much faster than normal for that time of year. The growing excess in supply wasn't yet reflected in the market, however. Benchmark oil prices continued to hover around the same lofty level they had occupied for the previous few years—near or above $100 per barrel. Increasingly this was considered the new normal.

Goldberg had just launched his BBL Commodities Value Fund the previous September, but he was hardly a newcomer to oil markets. He had spent the previous decade as a trader, first for Goldman Sachs and then for Swiss commodities giant Glencore. His strategy for BBL was to trade oil "across the barrel"—refined products as well as crude itself—and to stay focused on short-term opportunities while keeping one eye on the horizon. "Our views are three months, six months, maybe a year," says the 33-year-old Goldberg. "And we

are very sensitive to day-to-day, week-to-week fluctuations. I've never understood the point of putting a position on until I actually thought it was going to make money." That January he rode bullish bets on natural gas and U.S. distillate prices to a 7% monthly gain. But he began to realize that something bigger might be brewing in crude.

Goldberg and his team watched closely as the stockpiling accelerated. By the end of the first quarter, the trend was clear. A gusher of new supply driven by the stunning growth in U.S. shale oil production—accounting for most of the 80% spike in overall U.S. production since the end of 2008—was beginning to overwhelm demand. And yet oil prices continued to defy gravity, propelled by fears of supply disruptions. Russia's conflict with Ukraine and the emerging threat of a new Islamic state in northern Iraq caused crude to hit new highs in late June.

The trader stayed patient, waiting for a catalyst that would spur a drop. By the early fall Goldberg noticed that the cash prices being paid for physical oil were significantly lower than even the suddenly weakening futures prices. He became more confident that it was time to be short oil.

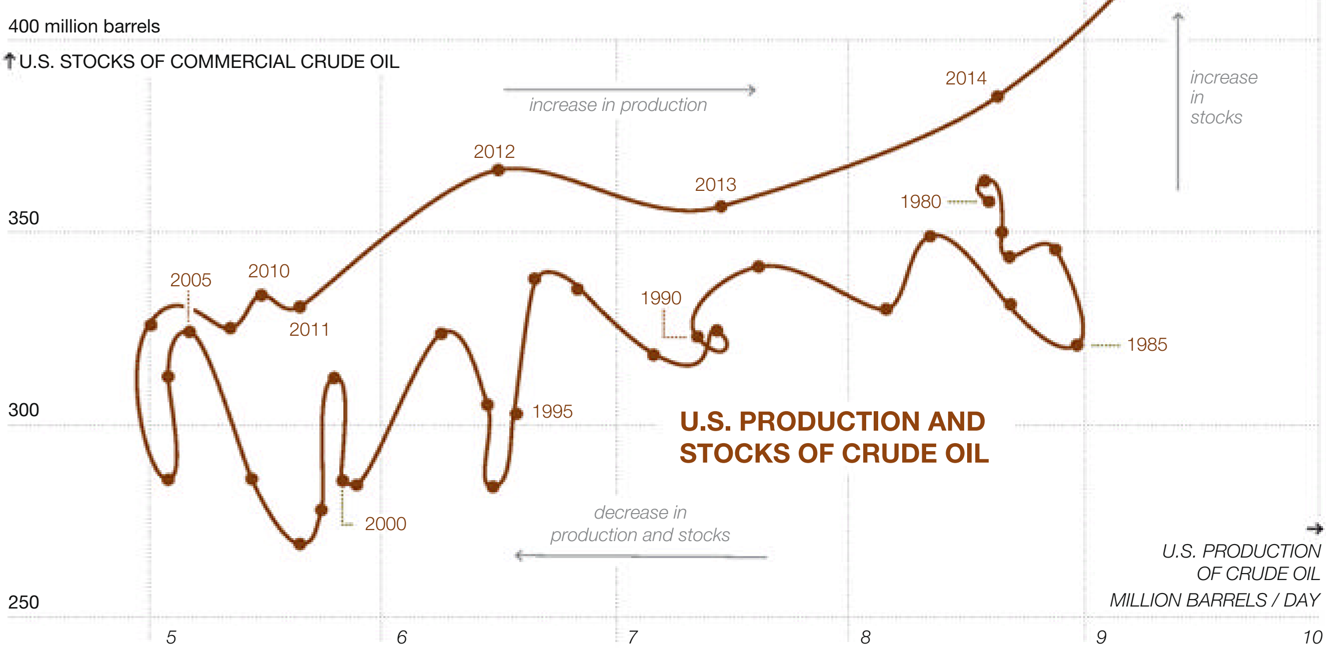
Then the bottom fell out. On Nov. 27, the Organization of the Petroleum Exporting Countries announced that, contrary to the assumptions of much of the oil industry, it would not cut its production to defend higher prices. Crude went into free fall. The price of a barrel of West Texas Intermediate (WTI), a benchmark for so-called light sweet crude oil, tumbled from its June high of $108 to a low in January of $44. Goldberg was well positioned for the crash. His fund made 26% in December alone and finished with a return after fees of 51.3% for the year, pushing assets up to $540 million.

Now the question for Goldberg and others is, what happens next? What are the implications of a 50% markdown of crude—in terms of cost structure, demand growth, and production? Will prices remain low for a sustained period or rebound quickly? To answer that, you have to study oil's new calculus. For the near term anyway, expect volatility, not consensus. "The only thing that there's agreement on is that it's a lot more challenging than the old math," says Dan Yergin, the vice chairman of information and analytics company IHS and the author of the essential oil-history tomes *The Prize* and *The Quest*.

For most of the players in the multitrillion-dollar oil and gas industry, crude's swift plunge has been almost as surprising as it has been costly. In November, S&P Capital IQ surveyed energy professionals and asked them what they thought the price of Brent crude would be at the beginning of January: $50, $80, or $100 per barrel? The most common answer (78%) was $80; just 2% picked $50. This conviction was based on a couple of assumptions: First, that the cost of adding new

The Serpentine Path of Stockpiling

After decades of declines, U.S. oil production has surged by more than 80% since 2008. That flood of supply has led to record levels of inventory in American storage facilities.



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production, in U.S. shale fields and elsewhere, was somewhere around $75 to $80 per barrel. Second, that Saudi Arabia, the driving force within OPEC and the shock absorber in oil markets for the past 40 years, would cut production if necessary to keep prices from falling too low.

Blinded by these beliefs, the industry as a whole failed to recognize what, in hindsight, should have been obvious: that a developing glut made a price correction almost inevitable—especially with the Saudis signaling that they had no intention of cutting back production. "This was what they call in science an 'available insight,'" says Jeremy Grantham, co-founder and chief investment strategist of asset manager GMO, which oversees $120 billion, and a widely respected identifier of market imbalances of all types. Grantham laments that he, too, failed to predict the price plunge.

The fallout from the drop has been swift and brutal. Publicly traded oil companies have lost billions in market value, and both public and private firms are moving aggressively to cut capital spending budgets for 2015—laying off thousands of workers and shutting down hundreds of rigs. This is especially true in the new boomtowns that have powered the shale oil revolution in the U.S. (For an on-the-ground report from North Dakota oil country, see "Waiting for the Reckoning.") If the downturn drags on, there will almost certainly be bankruptcies and acquisitions.

"What we're seeing is a textbook implosion with regard to exploration and production capital spending domestically because the industry was leveraged to very high oil prices," says Bill Herbert, a senior researcher at Houston oil and gas investment bank Simmons & Co. "And the E&P companies have been living outside of cash flow since the implosion of 2009, when the financial system essentially collapsed."

Indeed, a recent paper by IHS concluded that spending on production growth in the U.S. from 2009 through 2013 had exceeded cash flow by an astounding $272 billion—and at least 40% of that was raised by taking on debt. Additional credit will presumably be hard to come by. But industry observers are anticipating a wave of opportunistic investments by private equity firms. Blackstone, for instance, reportedly just raised $4.5 billion for a new fund focused on energy investments.

Meanwhile, the industry is taking a hard look at costs. "Companies are reorienting themselves to a low-price environment," says Yergin. "A decade ago they had to adjust to a higher price, and costs went way up." But even before last year's dive in prices, says Yergin, controlling costs had become the No. 1 issue for top execs at the major energy companies. "If that was a preoccupation before the price collapse, it's now an obsession," says Yergin.

Even as companies move quickly into survival mode on the ground, the industry is struggling to get a handle on future prices: Will the market's corrective forces bring supply and demand back into alignment in a matter of months? Or will this be more like 1986—an eerily familiar scenario in which an OPEC decision to keep pumping oil after a flood of new supply ended up tanking

"The only thing that there's agreement on is that it's a lot more challenging than the old math," says Dan Yergin.

Why Aren't Airfares Falling?

The major carriers are saving billions on rock-bottom oil prices. Shouldn't some of those savings be passed on to passengers?

BY JOHN CASSIDY

If you want to know who's benefiting from the drop in oil prices, you don't have to look far. "This was the best year in the long, proud history of American Airlines," Doug Parker, the megacarrier's CEO, said a few weeks back as he announced that American made a profit of $4.2 billion in 2014. Delta made even more money last year than American did: $4.5 billion. United netted $1.97 billion, up 89% over 2013. The airlines' profitability is good news for their shareholders—and for their employees, some of whom have been getting long-delayed raises. But what about passengers? Does the big fall in the cost of jet fuel mean we are getting a break on fares? Heck, no.

Recently I tried to book a family trip to London for April. The cheapest nonstop flights I could find from the New York area were about $1,250 each, or roughly $5,000 for the four of us. Suffering from sticker shock,

A ground-crew worker connects a fuel hose to the wing of an Airbus aircraft.

SIMON DAWSON—GETTY IMAGES

I considered switching to southern Florida or New Orleans instead. Flights to Miami started at just under $600, hardly a bargain. The cheapest flights to New Orleans were about $500. JetBlue, the "discount airline," wanted almost $600. Ouch!

I wasn't alone in feeling miffed. A few years ago, when the cost of jet fuel rose above $3 a gallon, the airlines quickly tacked on hefty fuel surcharges. Now jet fuel costs less than $1.70 a gallon, and the surcharges are still in place. Figures from the Department of Transportation confirm that airfares are as high as they've ever been. "We have seen six months of steadily dropping gas costs," says Paul Hudson, president of FlyersRights.com, a lobbying group for airline passengers. "By any measure, the money saved by the airlines should be reflected in lower airfares."

Why isn't that happening? Initially some people defended the airlines, saying their hedging strategies had locked them into buying jet fuel at high prices. That wasn't accurate. Some airlines, such as Delta and United, do hedge part of their fuel needs, using puts and calls. That gives them the right, not the obligation, to make purchases at prespecified prices. Unwinding the hedges can be costly, but it doesn't prevent airlines from taking advantage of lower fuel prices. Delta reckons it could save up to $2 billion this year: There's no indication it intends to cut fares. And some airlines, notably American, didn't do any hedging to begin with, so the slump in fuel prices went straight to their bottom lines. Small wonder American's CEO told analysts, "We believe 2015 will be yet another record year."

Arguably, the main reason that fares haven't fallen is that on many routes the big airlines now lack meaningful competition. During the past decade or so, they have slashed capacity, merged with competitors, and entered code-sharing agreements—all steps that help them maintain high prices. Take the New York–London route. Not so long ago there were more than a half-dozen airlines competing for passengers, and price wars were common. Today three big combines have largely carved up the routes among them: British Airways–American, Delta-Virgin, and United Continental. If you go to a travel site, you will find that fares are virtually identical on all those airlines. And as every frequent flier knows, they are consistently higher than they used to be.

That's partly because of all the surcharges. Sen. Charles Schumer (D-N.Y.), who is a member of the Senate Judiciary Committee, has called for a federal investigation into why the airlines haven't rolled them back. If you buy tickets directly from the airlines or on sites such as Expedia and Orbitz, the cost is seldom broken down. But Google's ITA software, which anybody can use, shows that on flights between J.F.K. and London's Heathrow, for example, American still levies a "carrier-imposed surcharge" of $458 per passenger. British Airways imposes exactly the same fee. So does Delta. So does United. Virgin charges $450. With jet fuel cheaper than it's been in years, what is the basis of those levies?

At the very least it would be good to see Parker and his fellow airline CEOs hauled up to Capitol Hill and asked to provide some answers. The same goes for the bright sparks at the Justice Department, who nodded through all those mergers and code-sharing agreements. "Because of the big airline mergers, competition has been squeezed out of the system," notes Charlie Leocha, the chairman of Travelers United, another consumer group. "With only three network carriers, airlines now have the luxury of ignoring the market and maintaining high prices and low capacity."

This isn't exactly unfamiliar territory. Until the latter part of the 1970s, when the late Alfred E. Kahn led the fight for deregulation and competition, high prices and restricted choices were the norm in the airline industry. Things aren't quite that bad today, and airlines are entitled to make a reasonable profit. But when competition fails, it's up to the authorities to find out what's wrong and propose a remedy. If we don't see cheaper airfares now, will we ever see them?

John Cassidy is a Fortune *contributor and a* New Yorker *staff writer.*

prices for years? After bottoming—at least temporarily—in late January, benchmark prices rallied in early February, with WTI reaching $53 and Brent at $62 as of presstime.

But crude production continues to surge as a result of wells already drilled—and stockpiles of the excess continue to grow. In early February the amount of oil in storage in the U.S., excluding the strategic petroleum reserve, reached 417 million barrels, according to the U.S. Energy Information Administration, the highest level at that time of year in at least 80 years. Barring a major disruption of supply elsewhere in the world, it's unlikely that prices will see a strong rally until those inventories begin to recede. But the slowdown in drilling should eventually put the brakes on production growth in shale. Unlike traditional onshore oilfields, which might have an annual production decline of 5% or less, shale oil wells often decline more than 50% in their first year.

The oil market remains in what's known as contango—with the future price of crude trading at a higher level than today's spot price. That suggests a belief that prices will rebound, at least somewhat. In mid-February, for instance, December 2017 Brent crude futures were trading above $73—or about 18% higher than the spot price. This has led traders to take oil off the market—in some cases by leasing supertankers for extra, floating storage capacity—in hopes that they will be able to sell it back later at a higher price. "It's not a mystery," says Chris Bake, a member of the executive committee of Vitol, the world's largest independent oil trader. "We do it here because the market is asking us to do it. It's saying, 'Gentlemen, we do not have a home for this oil today. Can you please take it off my hands?'"

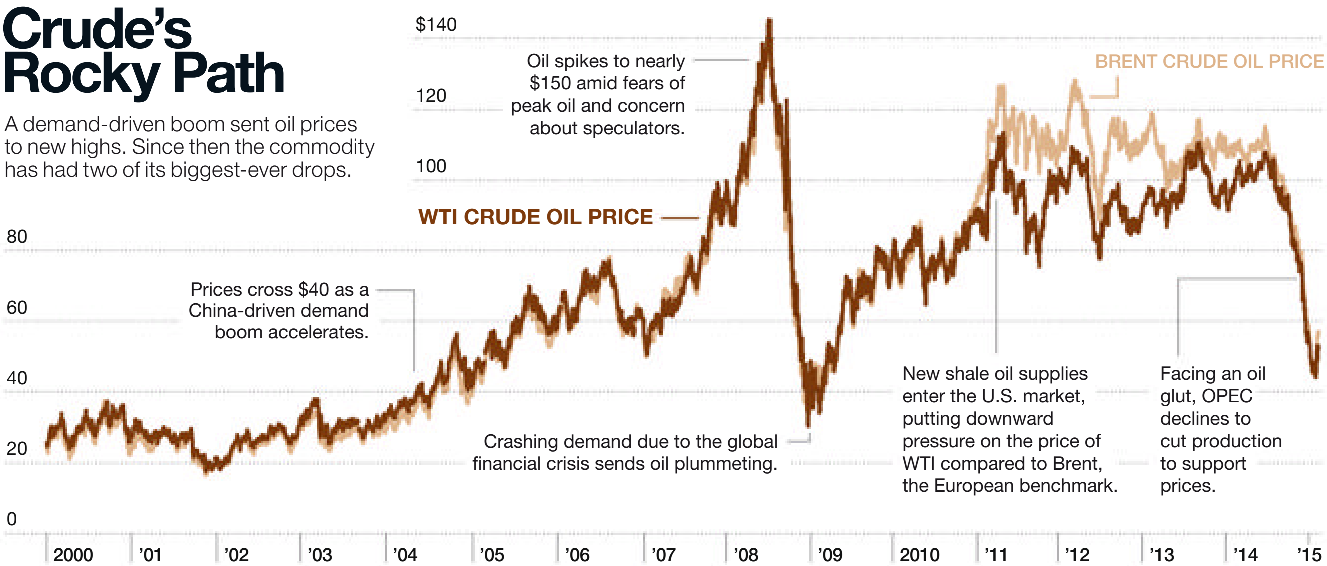
The outlook for consumption is murky. The International Energy Agency has lowered its demand forecast several times in the past couple of years, and in a recent report cautioned that both China, the biggest demand driver, and the global economy more generally were becoming less fuel-intensive. Still, the IEA projects demand to grow by more than 7 million barrels per day over the next five years. While lower crude prices mean cheaper gasoline in the U.S., which should spur demand, that's not so much the case in other countries, where taxes represent a higher portion of the cost of gas (as in Europe).

A pair of recent reports suggest that the industry can stay in hunker-down mode for a while—as long as prices don't crash much further. In January energy specialists Wood MacKenzie analyzed its database of 2,222 oil-producing fields around the world and found that a mere 0.2% of the world's supply would be operating on a cash-negative basis at $50 per barrel for Brent. At $40, the number rose to just 1.6%. And a study

> "The market is asking us to do it. It's saying, 'Gentlemen, we do not have a home for this oil. Can you please take it off our hands?'"

Crude's Rocky Path

A demand-driven boom sent oil prices to new highs. Since then the commodity has had two of its biggest-ever drops.



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As inventories pile up, more oil is being stored in tanks, like these in the area surrounding Cushing, Okla.

by IHS concluded that wells accounting for 47% of new U.S. oil production in 2014 could break even with the price of WTI below $61.

Once supply and demand come back into balance, points out Fadel Gheit, Oppenheimer's senior oil analyst, prices should gravitate toward the marginal cost of production of new barrels. But where that ends up is another subject of debate. Five years ago, says Gheit, the industry needed oil at $90 to justify the development of new production of U.S. oil shale. Now that figure is significantly less, he believes, and continued technology gains will drive it lower. "I've been following this industry for 30 years," says Gheit, "and I can tell you that the shale revolution has changed the calculus. In my view shale will never die. It's here to stay." He forecasts higher prices but not a return to triple digits.

Grantham has a different view. After studying oil prices over long periods, the GMO chief strategist has come to believe that there have been two major paradigm shifts when oil reset at higher baseline levels. For decades, he says, the base price, calculated in today's money, was $16. From there, oil occasionally doubled or dropped by half, but tended to return to $16. The rise of OPEC in the 1970s changed the game, says Grantham, and the baseline price jumped to $35. "Whenever you were down by half, of course, it was the end of the world, it was a New World Order," says Grantham. "And whenever you went up, the same in reverse."

Just after the year 2000, Grantham maintains, the cost of oil inflected as finding new supplies became more challenging and expensive. That drove the base price up to $75 or $80 per barrel. Since then we have experienced both the doubling (when oil surged to nearly $150 in July 2008) and the halving (when it crashed below $40 in December 2008). Despite the gusher of U.S. shale oil production, Grantham believes that prices are likely to reset higher again—to a baseline above $100—because, outside of shale, finding new oil is getting harder. And there won't be enough shale production to cover the declines of existing supplies and meet future demand growth. "If you look at the size of the oilfields discovered, they get smaller and smaller at a heartbreaking rate," says Grantham. Recent data support the observation. According to IHS, non-shale discoveries have fallen sharply since 2010, and 2014 is "likely to mark" the first year since the 1950s that no conventional giant oilfields (those with more than 500 million barrels in reserves) were found.

But while Grantham projects that oil will surge higher in the medium term, he ultimately—perhaps 20 or 30 years down the road—sees advances in technology making oil virtually obsolete in transportation. "It's a wonderfully complicated world, isn't it?" he says.

As for Goldberg, he plans to stick with his process and let the market guide him. The same indicators that made him bearish on prices, he says, could signal that prices are destined to rise again. "I can see a scenario where oil prices get super-bullish again if companies overcut," he says on a recent morning, sitting in his conference room on the 38th floor of an office tower at the bottom tip of Manhattan. But he's not positioned for that yet.

Meanwhile, he's staying away from big theories or bold predictions. "There's no key to the puzzle," says Goldberg, who earned a degree in economics at Yale and wrote his thesis on behavioral finance under the guidance of David Swensen, the manager of Yale's endowment. "It's not like anyone can sit there and figure it out. Like, 'Hey, oil's going to be at $50 in three years.' Well, maybe. I mean, if demand doesn't grow, and industry cost cuts are 20%, and we don't have a war with Ukraine, and Saudi Arabia doesn't change its oil policy, and Libya maybe comes back online, and Nigeria doesn't blow up—yeah, we'll probably be at $50. Good luck getting any one of those variables right." To solve oil's new math, Goldberg knows, it's better not to look too far ahead. F

DANIEL SHEA

FEEDBACK *bokeefe@fortunemail.com*

THE GOLDMAN SACHS – *FORTUNE* GLOBAL WOMEN LEADERS AWARD

Celebrating the Power of Women

At this year's *Fortune* Most Powerful Women Summit, two rising star women from developing countries were honored with the Goldman Sachs – *Fortune* Global Women Leaders Award. Gary Cohn, president and COO of Goldman Sachs, helped to honor these business owners who effectively apply back home lessons learned through mentoring programs and, as a result, represent the multiplier effect of investing in women.

Rehmah Kasule of Kampala, Uganda, a participant in the *Fortune*/U.S. State Department Global Women's Mentoring Partnership, is the founder and president of CEDA International. Her organization's Rising Stars Mentoring Program has impacted 12,000 girls, her UniAction Program works with eight universities to prevent human trafficking and exploitation, and her Youth Engaged Program has provided leadership and entrepreneurial skills to 947 youth and 200 single mothers. President Obama recognized her work at the Presidential Summit on Entrepreneurship, and she won the World of Difference 100 award, given by the International Alliance for Women.

Gircilene Gilca de Castro of Belo Horizonte, Brazil, an alumna of the Goldman Sachs *10,000 Women* initiative, is the owner of Alimex Soluções em Alimentação Ltda., a corporate catering business. In joining *10,000 Women*, Gircilene was determined to restore her company and change the business environment for women. Since graduating, Gircilene has leveraged the learnings from the program to realize significant results: a 900% increase in revenue as well as hiring more than 40 new employees. She has also utilized her expertise to support women in her community.

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Golf is different. Its professional Tours, led by the PGA TOUR and its over-50 Champions Tour, let fans play along with the game's stars in pro-am events on the tournament courses. Pro-ams normally take place on Wednesdays, the day before a tournament proper begins, though there are even a few events—including the PGA TOUR's AT&T Pebble Beach National Pro-Am and the Desert Classic, in partnership with the Clinton Foundation—in which amateurs play alongside pros during the official competition. Open to anyone with sufficient means, the pro-am playing privilege isn't generally bestowed upon just anyone. Entree inside the ropes has proven a winning business tool for corporate sponsors, a major reason why large global companies have been such longtime supporters of professional golf.

"To spend five hours in the company of one of the game's best players in an intimate setting, with two or three of your best customers or prospects—it's remarkable," says Peter Kent, the PGA TOUR's SVP of tournament revenue.

THE SHELL HOUSTON OPEN

The Shell Houston Open generally occurs the week before the Masters Tournament in April, which helps draw a strong field of pros. Spots for the 208 amateurs in the pro-am, which run $6,500 each, are often reserved by the tournament's major backers, starting with the title sponsor. Senior executives hosting key stakeholders typically claim these spots, says Shell Houston Open tournament director Steve Timms. He adds that the pro-am has proven so high-value that Shell typically purchases


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additional playing spots in the field.

"Wednesday is our most important day of tournament week, the day we hold our breath about the weather," says Timms. "All our biggest sponsors and their guests are there, and it's one of our most profitable days."

Operated by the Houston Golf Association, the tournament has raised more than $60 million for charity since 1974. Last year alone, it raised $2.2 million for the HGA's designated charities, scholarship fund, and youth programs, including the local chapter of The First Tee, a World Golf Foundation youth initiative that teaches life skills and leadership through golf. Though the Wednesday pro-am is subsumed into the net proceeds of the tournament, "it is very impactful on that [charitable donation] number," Timms says.

For the lucky players involved, of course, there are also the celebratory pleasures. The Shell Houston Open pro-am includes a cocktail reception earlier in the week where a drawing pairs amateurs with pros. On the day of the event, players receive credit to a tent full of new gear from the likes of Titleist, TaylorMade, and Callaway. They may warm up with the pros. There are full breakfast and lunch spreads. Food stations are set throughout the course. Hors d'oeuvres and an awards ceremony follow the pro-am's completion. "Nobody goes home hungry or thirsty," Timms notes.

John Senden, an Australian pro, has participated in dozens of pro-am events.

ZURICH CLASSIC OF NEW ORLEANS

Zurich Insurance Group has a similar story to tell as title sponsor of the Zurich Classic of New Orleans since 2005. In that time, the tournament has donated $13 million to more than 100 charities, while having an economic impact of more than $40 million annually for the city. Many of the company's employees participate in volunteer opportunities like the St. Bernard Project, helping to rebuild homes destroyed by Hurricane Katrina.

Some play in the pro-am, often with key customers. "The pro-am is a great way to build relationships," says Gregory Renand, global head of sponsorship and thought leadership marketing for Zurich Insurance Group. "Our involvement is about supporting one of our customers' passions, as well as associating our brand with positive, emotionally charged moments in golf. To have the unique opportunity to play with some of the best players on the TOUR in the pro-am, it's a once-in-a-lifetime experience."

THE PRO: FOR THE LOVE OF PRO-AMS

Australian veteran pro John Senden has played in dozens of pro-ams in his career. It's an integral part of the PGA TOUR experience, explains this defending champion of the Valspar Championship. "If you're eligible for the Wednesday pro-am and don't play, you're not playing in the tournament proper on Thursday," he says.

Senden speaks about the importance of pro-ams to the tournament itself, its charity affiliations, and the crucial corporate relationships that support the game of golf as a whole. "Other than the TV rights, the pro-am is probably what the sponsors value the most," he says. "Our role as pros is to serve as value to the sponsors and give the amateurs the best possible experience."

The pros offer the odd swing tip, praise, small talk, and pretty much everything aside from business talk.

"The amateurs are out there for a good time. They're mostly interested in what the pros are doing, as well as their own game," Senden says. "They often say that they wish they could do what we do for a living, and I appreciate that. Even if it is a job, we are in a great position to play golf for a living, and we try to give that good fortune back to the guys and gals by having a good day." Senden says that he and his colleagues send handwritten thank-you notes to each of their amateur partners.

Timms of the Shell Houston Open has found that pro-ams are a chance for pros not only to interact

The Zurich Classic of New Orleans has donated $13 million to more than 100 charities since 2005.

with their fans but also to potentially create new business relationships. "Five hours getting to know someone is a unique opportunity," he says. "In our opinion, pros are very wise to strike up relationships with these senior executives."

> Entree inside the ropes has proven a winning business tool for corporate sponsors.

THE SPONSOR: CREATIVE INVOLVEMENT

Located in Pascagoula, Miss., Ingalls Shipbuilding is the nation's largest builder of non-nuclear ships for its two clients, the U.S. Navy and U.S. Coast Guard. When the Champions Tour debuted the Mississippi Gulf Resort Classic five years ago in nearby Biloxi, the company came aboard as a sponsor, and its goals weren't just bottom-line-oriented.

"Whenever we have an opportunity to showcase the military, we take it," says Jim McIngvale, Ingalls Shipbuilding's director of government and community affairs. "The folks running the tournament have done a great job of coming up with innovative ways to do that." They've invited uniformed military to greet players on the 18th hole during the final round; in 2015, the tournament plans to have a specific military reception area with refreshments. Ingalls Shipbuilding has previously sponsored the clever HUSH Y'ALL signs requesting silence as a player prepares to hit his shot. The company distributes tickets to employees, saving pro-am spots for employees who are military veterans.

"The tournament has been a fantastic opportunity to get the company name out, to help the local community, and to bring positive recognition to our military partners," says McIngvale. "We've had countless people reach out to us and say, 'I saw your military tent' or 'I saw your logo on the signs.' It's been good for both employees and the community."

Similarly, McIngvale has been pleased not only to hear pros and amateurs talk fondly about the Sanderson Farms Championship in Jackson, but also to see sponsoring companies return to Mississippi's PGA TOUR event.

"So many companies make second, third, and fourth trips to the state after their first exposure to the TOUR," McIngvale says. "It's obviously been a positive force for recruiting in Mississippi."

Just as pro-ams have proven a positive force for business in general. ● —Evan Rothman

Waiting for

Oil has plummeted, but inside the heart of fracking country in the boom

the Reckoning

towns of North Dakota, fear is only just beginning to replace optimism.

BY JENNIFER REINGOLD

PHOTOGRAPHS BY GEORGE STEINMETZ

TWILIGHT OF AN OIL RUSH? A fracking rig near Williston, N.D.

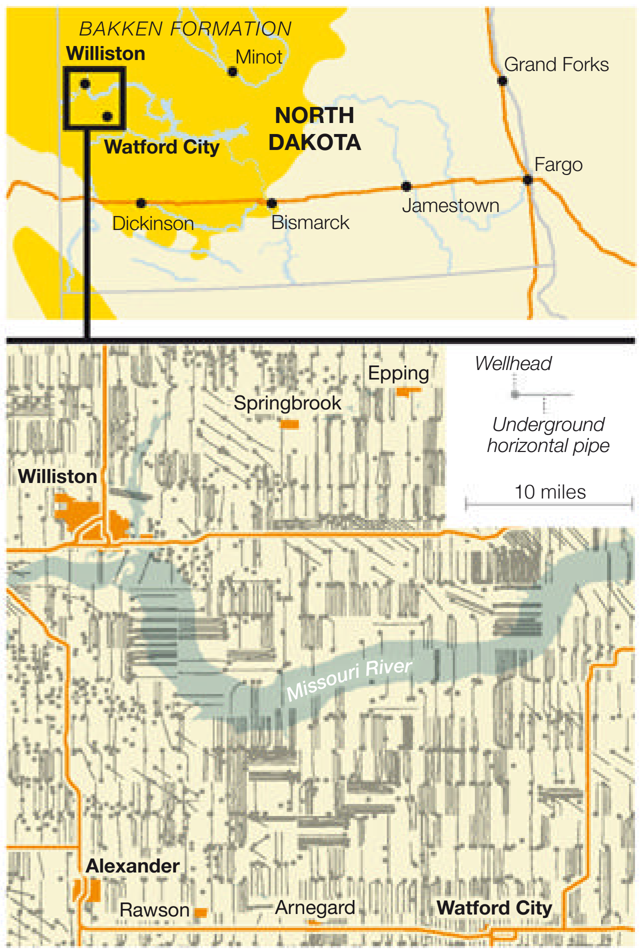
W

WE'RE STANDING ON A WINDSWEPT, SNOW-COVERED expanse of frozen ground in western North Dakota, imagining a future that is hard to picture here. Gesturing toward a grassy field, hatless in the 10-degree chill, Terry Olin and Ellen Simone Weyrauch, the principals of a real estate development firm called Stropiq, lay out their vision for Williston Crossing. They've planned a $500 million, 219-acre complex with 900 residential units, a hotel, a water park, and tons of big-box retail. As soon as Stropiq gets the expected approval from the county, it will break ground later this year and hopes to finish the first phase of construction by 2018.

Just 10 years ago the area was an American Empty Quarter, with nothing but a few grain farms and the occasional oil well, conjoined by the lonely two-lane U.S. Route 85, part of the CanAm Highway that connects Mexico to Canada. But then came an oil boom propelled by the advent of fracking, the technology for getting oil out of formerly impenetrable rock by fracturing it. In North Dakota's Bakken Shale, oil once considered irretrievable flowed freely.

Now, as Olin and Weyrauch gaze down at Route 85—soon to be four lanes—from their site, they see all the signs of a roaring economy: tankers loaded with oil, trucks piled high with pipe, and new SUVs. Nearby sit several pump jacks, pulling oil all day and all night from the shale thousands of feet below. Olin, who made his money developing property in Russia, sees the Bakken area as one of the best opportunities in the world. He has moved here from Switzerland to make it happen. "This has become the best emerging-market play anywhere," he raves.

In August 2013, Williston, N.D., erected a sign at the entrance to town. WELCOME, it reads, TO BOOMTOWN, U.S.A. That's understating things. There are now about 40,000 people living here, up from 12,000 less than a decade ago. They have come from all over the world to find work, in the



GRAPHIC SOURCE: NORTH DAKOTA DEPARTMENT OF MINERAL RESOURCES

OIL TOWN, U.S.A. Clockwise from top: Downtown Williston; Terry Olin and Ellen Simone Weyrauch on the site of Williston Crossing; Christine Stief and Brad Owren with their daughter, McKenzie, outside their trailer; a map of the area shows not only a profusion of wells, but horizontal drills underneath much of the earth there.

time-honored tradition of the gold rush. For years jobs went begging, with some of the highest wages in the country. At the end of 2014, Williston's unemployment rate was 1.0%, the lowest in the U.S. Given those statistics, it is logical that Olin and Weyrauch would want to invest in a place so starved for commerce that the local Wal-Mart—one of the chain's highest-volume locations—used to routinely run out of basic supplies.

Then came the swoon. After reaching a 12-month high of $108 last summer, U.S. benchmark petroleum prices have dramatically declined, to a price now hovering near $50 per barrel. That has shaken global markets and energy companies alike, causing oil producers to slash their capital expenditure budgets and announce layoffs. The situation will only worsen if the low prices persist.

That's particularly true in North Dakota, where oil is costlier to get at than in many other parts of the world. The causes for the collapse include basic supply and demand—the slowdown in China's economy combined with the surge in U.S. oil production—abetted by Saudi Arabia's decision not to restrict supply in hopes that it will retain market share and cause a shakeout among less cost-effective sources of oil.

You'd think all that would be enough to create panic in a place like Williston, where most jobs directly or indirectly depend on oil. And yet over the course of several days spent in the area, speaking with everyone from developers like Olin to restaurant servers to energy CEOs to oilfield workers to public administrators, I experienced a strange cognitive dissonance: an insistence that nothing has changed, combined with hard-headed determination and an undercurrent of fear.

"This is not your father's oil boom," says David Montgomery, a commissioner of Williams County, which includes Williston. He has lived here his whole life and believes that the area has seen so much growth that even a slowdown won't halt the vast infrastructure needs. Others, such as Scott Busching, the sheriff of Williams County, see what's happening as merely a "lull," one not so dissimilar from most winters, when the economy slows because the ground freezes to a depth of six feet, making many tasks impossible. "This boom's got legs," he says.

Olin, the developer, says he's undeterred by recent events: "Should we stop and wait until [the price of oil] is $60? Is there some scenario in which it makes no sense? I think not." He insists that his investors remain confident. But if they get nervous, Williston Crossing will likely never be built.

The cold is piercing. The trailers look as if they would huddle together for warmth if they could. It's impossible to imagine a child playing outside.

Today Williston conveys the sense of a place willing itself forward. Some think plenty of bonanzas are still to be made. Others rue the boom and wish it had never happened. It feels a bit like Wile E. Coyote in the seconds after he has run off the edge of a cliff and is suspended in air. Will this be the first time he makes it back to the high ground without plunging?

THE PRICE OF OIL FEELS BESIDE THE point when you see the prairie from 1,000 feet, flying in a four-seat Cessna. Rigs dot the Williston horizon; natural gas not valuable enough to be captured burns orange in open flames. Trucks speed down the highway. Trailer parks, neatly arrayed in rectangles on white stretches of snow, are plentiful—as are half-finished housing complexes. A depot for freight cars looks like a child's train set, with so many cars ready for loading that they almost cover the entire circular track.

Back on the ground, everyone seems to know the rig count —how many drills are digging for new oil—whether he works in the oil patch or not. It's hard not to know the number: It's printed on the front page of the local paper, the *Williston Herald*, every day. In June 2012 that number peaked at 203; during my five days there it dropped from 145 to 137. A week after I left it was 126.

Still, that has done nothing to dampen the scene at the Williston Brewing Co., one of the town's hottest new restaurants. Developed by a Minnesota businessman, it opened in September 2013 to crowds eager to sample "big city" food like jerk chicken and sweet-chile-glazed salmon at its 65-foot redwood bar. Tonight it's packed with the beneficiaries of the boom, and no one here thinks the party is ending.

One of them is Nyssa Gray, who has cashed in with her Pepto-Bismol-pink drive-through coffee hut, Boomtown Babes Espresso. It's not just the coffee that gets the truckers to line up and pay $5.50 for a large cappuccino; it's the scantily clad "babe-a-ristas" inside the shed. Gray, herself a striking ambassador of the brand with her platinum-blond hair and cartoonish figure, came here from Washington State and opened Boomtown Babes in mid-2013. "It blew up bigger than I ever imagined," she says.

As she sips Goldeneye Pinot Noir and nibbles on a shrimp cocktail, Gray says there's no sign of a slowdown: Sales in January were up 44% from the year before. Now she's expanding to other oil centers, including nearby Tioga, and says she is partnering with a production company on a reality show about her operation. What about the slumping price of crude? It's just a blip, Gray declares. "I'm not going to instant-

IN THE SHADOWS
A trailer park just outside Williston

ly pack up and move," she says. "This is my baby—everything I worked so hard for. So heck yeah, I'm gonna ride it out."

Few people in the Bakken—or anywhere, for that matter—anticipated a slowdown. Just last September the North Dakota Department of Mineral Resources published a report projecting that up to 6,000 additional wells could be drilled in McKenzie County, the county adjoining Williams, by 2025. (There are now about 2,700.) In Watford City, about 45 minutes southeast of Williston, the number of building permits doubled between 2013 and 2014, rising from 262 to 511; approved apartment units soared from 89 to 1,152 in just one year. Housing is so scarce that two-bedroom apartments rent for an average of $2,800 a month. Demand has not abated, says Charlie Rader, chief operating officer at McKenzie Building Center, an 80-year-old building-supply company based in Watford City. "We are fully engaged on our projects."

A few miles away stands the steel skeleton of what will soon become Watford City's new, $50 million high school. It couldn't come soon enough for the district, which has seen annual 20% to 25% increases in the number of children. In 2014, between the end of one school year and the start

CASHING IN Top: Workers' coats and boots at a "man camp" owned by Target Logistics, which says business remains strong. Bottom: Boomtown Babes Espresso is planning to open more coffee huts.

of another, 251 new students registered, raising the total to 1,331. Once mostly local and white, the elementary school now educates natives of 48 states and 20 countries. Some 38% are classified as "homeless," many because they live in trailers or RVs; rent is simply too high.

Watford City has taken a big financial risk on the school. It is issuing $27 million in bonds and has borrowed millions more. District superintendent Steve Holen is now trying to persuade the state legislature to force the oil industry to cover some of that debt. "We want to see portions of industry pay for this," he says, "because that's where the impact has come from."

Holen understands that a slowdown will probably mean trouble for state budgets—which support schools, of course—because of a state law that lowers oil companies' extraction taxes on new wells from 6.5% to 2% if the NYMEX average monthly price per barrel falls to $57.50. As of Feb. 1, that trigger was activated, so oil companies won't have to pay the full 6.5% until the price rises above $72.50. If it remains below $55.09 for five consecutive months (we're now in month two), the companies will pay no extraction taxes on any wells drilled after 1987, which is to say the vast majority. How dire would that be for the state? Already the North Dakota legislature has slashed its estimates of oil and gas revenues through 2017, from $8.3 billion to $4.3 billion.

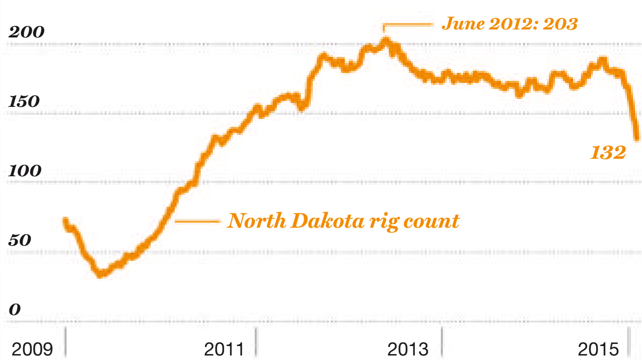
Even if oil prices stay low, the Watford City/Williston area may be the last in the region to feel the pain. It is in the "sweet spot" of the Bakken, with the breakeven price for production about $36 a barrel, according to the state. That figure runs as high as $77 in some other parts of North Dakota. Another reason the pain has not yet become apparent is that even as companies slow their rate of drilling, they must still complete the wells they have started—or lose the substantial investment they have already made. Scott Junk, VP for marketing at Target Logistics, which runs three local "man camps" (facilities that provide spartan dormitories and food for the mostly male oilfield workers), says they are running at 90% occupancy. "We haven't adjusted our business plans at all."

THERE'S AN OLD SAYING THAT THE only people who profit from a gold rush are the ones who sell the picks and shovels. People who use them don't fare as well. You'll see that darker picture about 10 miles outside Williston. There a 20-foot bust of Abraham Lincoln watches over traffic from the side of Route 85. To the east is the entrance to the Lincoln RV Park, home to Brad Owren, 29, Christine Stief, 28, and their 17-month-old daughter, McKenzie.

The cold is piercing; the eight trailers remaining at the RV park, each about 10 yards apart, look as if they would huddle together for warmth if they could. It's impossible to imagine a child playing outside. But it is here that Owren

Tailing Off in the Bakken Shale

The number of rigs drilling new oil wells in North Dakota serves as a good indicator for the fortunes of the industry in the state.



GRAPHIC SOURCE: BAKER HUGHES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and Stief sit, fretting about their dwindling supply of canned SpaghettiOs and chicken noodle soup, hoping that a job will come through before their meager savings run out.

An unskilled laborer with a GED, Owren had struggled to make ends meet in Stevenson, Wash. "I searched for work for two years straight," he says. Then a cousin told him about Williston. "This is a town that's booming," he said. "You need to get here right now."

Owren packed up, left Stief, and moved to Williston in 2012. It seemed like the proverbial land of opportunity. He toiled on a rock-crushing crew, living in a man camp, and saved good money. Lonely, he returned to Stief and their new daughter after a year—but once again couldn't find a job in Washington. So last August the family moved to North Dakota with $800 in savings. They put a down payment on an $11,000 camper and had it towed to the trailer park. Stief intended to stay home with their daughter, because day care was exorbitant—$250 a week.

But things went sour quickly when the water pipes froze in the camper. Owren took two days off to fix them—he used a hair dryer to thaw the pipes—and says he was fired as a result. "[My boss] told me I was replaceable," Owren says, "and I understand that. But my family comes first."

His layoff coincided with the fall in oil prices. He hasn't found work since. "I have always been a positive person," says Stief. "But being here is the first time I have ever asked myself if there is an end in sight." They've resolved to stick it out; in mid-February, Stief took a job as a restaurant hostess, although it barely covers day care. Even if they wanted to leave, they couldn't. They don't have access to a truck that can pull their trailer. "The first time I was here I could have a different job every day if I wanted to," Owren says. "Now I can't find an equipment-operating job. That's unheard-of in North Dakota. But there's hope. There's always hope."

BOONS AND BANES From top: Superintendent Steve Holen at the future school, which will serve the flood of new arrivals; cleaning up the wastewater spill on Ron Sylte's wheat farm

SO MUCH FEELS TRANSIENT IN Williston. There doesn't seem to be a single local inside a packed Buffalo Wild Wings grill—90% of the patrons are male—on Super Bowl Sunday. My waitress, for example, comes from Zimbabwe. Over a couple of tequila shots, I get to know Jimmy Hand, a ginger-haired 29-year-old from Jacksonville. "I was going to go to Alaska and work on a crab boat," he says, "but then I heard about this place on a talk radio show." He came by train about a year ago, he says, with $20 and two changes of clothes. He was lured by a Craigslist posting that promised construction jobs for $27 an hour, a huge sum for someone with only a high school education and no specialized experience.

By the time Hand arrived, the offer had dropped to $17. He stayed but soon learned that getting rich wasn't easy. "I didn't know the cost of living," he says. "You'd spend $20 for a meal and not even be full." Even before crude prices dropped, he says, it became hard to find unskilled work. He's leaving for Florida that night on a four-day bus ride but insists he'll be back. "There's definitely still an opportunity here," Hand says. "You just have to be smart."

Even many of those who are succeeding seem to have no intention of staying. One example is Danny Hogan, a Brit and the group COO of NDD Group, which owns the Great American Lodge, a man camp. He lives here several weeks, then goes back to someplace else—in his case, England—for a week. He says he'd never move his three sons here. ("Would *you*?" he asks.)

Natives like Ron Sylte are ambivalent. For them the flush times have brought benefits—and harm. A wheat farmer in Tyrone, a few miles outside Williston, Sylte discovered on Jan. 6 that the state's largest-ever spill of brine water—the salty, contaminated water pumped back out of the well after fracking—had occurred on his property, leaking at least 3 million gallons into the earth so far, as well as into the Black

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A few don't conceal their anxiety. "There's a sense of panic," says one oil worker. "About three weeks ago our managers told us to start saving."

Tail Creek, which eventually flows into the Missouri.

A photographer and I arrived at the spill site on Feb. 2. Representatives of Summit Midstream LLC, the company responsible for the spill, instructed us to get off the property, even though the land belongs to Sylte, not Summit. "Call this number," we were told; it was that of a crisis-communications firm. Summit later provided a statement that it is "committed to North Dakota," including the "clean-up and remediation of the produced water release ... We are making significant progress in these efforts, and remain fully committed to addressing the impacted land and waterways as quickly as possible."

A few days later we returned, thanks to Sylte, a gentle, mustachioed man whose previous brush with the media occurred when *Farm Progress* reported that his agricultural sprayer is the world's biggest. We watched as an excavator dug shovelful after shovelful of dirty, icy soil out of the creek. The refuse was dumped into a pile some 15 feet high, while trucks continued to pump liquid out. When we asked if there was oil in the water, a man in a blue hazmat suit pointed downward: "Do you see that iridescent sheen here?"

Sylte is worried. He says he won't really know the impact of the spill until the ground thaws later this spring; a smaller spill in the area is still being cleaned up, nine years after it started. When asked how he feels about what fracking has brought, Sylte is silent for a while. "We've benefited from the boom," he says finally, referring to the mineral rights he holds on his land. "But way of life? I'm not so sure. We were happy the way it was before."

So, too, was Williams County sheriff Scott Busching, who has held the position for 17 years. The last several, he says, have been more like policing in a large city than a small town. "Whatever you have in New York City you have here," he says. "The same kinds of drugs, the same kinds of gang members." Heroin turned up last year, he says. "We weren't prepared." In 2009 the county opened a new jail, with 132 beds, to replace a previous facility that could house 37. Today there are 156 inmates—so many that closets and rooms once used for GED classes are being used as cells. Prisoners doze on dirty mats on the ground. Many eat sitting on the floor because there aren't enough tables. Busching says the courts are so backed up that they are now scheduling jury trials for the spring of 2017. At least the heat works.

From a law-enforcement perspective, Busching says, it doesn't matter whether crude prices quickly rebound. "If oil comes back, we get more people and more crime," he says. "If it doesn't and people lose their jobs, it's going to get busier." Busching says thefts have jumped of late, but he says it's hard to glean the cause. He can't even calculate a local crime rate because so many people move here without changing their address that it's impossible to determine the population.

CERTAIN INDUSTRIES, OF COURSE, may be largely immune to a slowdown. At the Heartbreakers strip club in downtown Williston, owner Jared Holbrook was focused on reopening after his club (and Whispers, right next door) was temporarily shuttered for various violations, including fighting and underage drinking. "This is a great place to do business," he says with a chuckle. "Everybody in the city wants to be here at the club." He sees no reason to pull out.

In mid-February the *Williston Herald* predicted there would be no major oil-company layoffs in the short term, though there were a lot of references to "efficiencies." For all the bravado, a few don't conceal their anxiety. "There's a sense of panic," says James Stumpp, originally of Tallahassee, who runs a completion rig and says he's been through busts in other states. "About three weeks ago our managers told us to start saving." His wife was planning to join him this summer, but now he's not sure if she should come.

Denishia Bradshaw, a secretary who arrived a year ago with her husband, an oilfield worker from Virginia Beach, says 10 people have already been laid off at his company. If things don't change by May, she says they told him, there will be "drastic cuts." Even kids are feeling the stress, it seems. "One thing we have noticed is a lot more tummy aches," says Brenda Herland, principal of the Garden Valley elementary school.

What will happen in three years? Will there be a festive opening of Williston Crossing? Olin is looking forward to it, but others aren't so sure. Joshua Stansbury, captain of the local Salvation Army, says the need for social services is growing rapidly, as people either show up and can no longer find easy work or lose the work they had. "We used to see 20-some people in a week," he says. "Now we see 20 or more in a day."

There's no homeless shelter, so the organization has been buying some people one-way bus tickets out of Williston. "The idea is not just to get people out of here," Stansbury says. It's simply the most humane choice. "Maybe," he says, "it's just best for some of them to go back home."

FEEDBACK *jennifer_reingold@fortune.com*

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Back on Target?

The discounter has seen its cool cachet wane, endured a calamitous hacking, and vaporized $5.4 billion in a failed Canadian expansion. New CEO Brian Cornell is decisive and energetic. Will that be enough to revitalize the retail giant?
by Phil Wahba

PHOTOGRAPHS BY
ACKERMAN + GRUBER

The Target executives were taken aback. They had just learned that their new CEO, Brian Cornell, had been out on his own with customers, incognito, exploring one of the company's stores. ¶ It was a big departure from the way the process-heavy discount retailer had always operated. Store visits, ostensibly intended as intelligence-gathering missions, were meticulously planned affairs, only slightly less formal than, say, a presidential visit. Every relevant national manager and local functionary would be notified in advance, each step choreographed, the "regular shoppers" handpicked and vetted. About the only thing missing was a brass band playing "Hail to the Chief." ¶ But on a mid-October day, just two months after he took the helm, Cornell took an unannounced detour from a business trip to Dallas. A friend

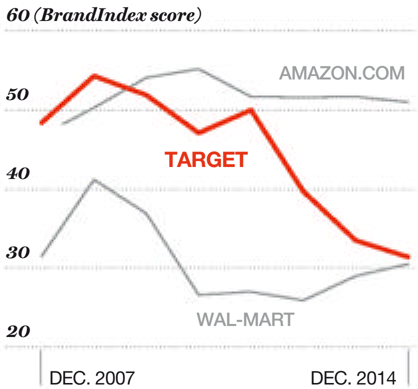
Brian Cornell with Bullseye at Target's "living lab" in northeast Minneapolis

connected him with an assortment of seven local moms, each of them loyal Target customers. Unrecognized by store workers, Cornell deployed each member of his ad hoc focus group to the department she frequented most—clothing, housewares, or groceries, for example—then waited for their reports.

What Cornell sacrificed in pomp and circumstance, he made for up in candid opinions. The shoppers had a bevy of comments and complaints. Two Latina mothers criticized the bland colors and general drabness of Target's apparel. The younger moms told him that they buy only organic food for their babies; they wanted greater selection. By the end of his two hours in the store, Cornell had some germs of what only a few months later, as we'll see, are significant changes he is planning.

It may seem like a small step. But Cornell is the first Target CEO to be recruited from outside the company, and fittingly, he is already bringing a jolt of fresh energy to the country's third-largest retailer (behind only Wal-Mart and Costco). "I got such great, genuine feedback from them," Cornell says of the Dallas visit. As he puts it, providing advance warning ensures stores are "going to be beautiful—but it's not reality."

Shoppers' Perception of Value Offered by Stores



GRAPHIC SOURCE: YOUGOV BRANDINDEX

A firm grip on reality is only the beginning of what Target needs today. A company that became a national phenomenon with retail alchemy—a rare ability to attract millions with hip designer items at clear-out prices—has seen that delicate formula stifled by excessive caution and a strangling bureaucracy, even as competitors emulated Target's approach, and fast-fashion retailers like H&M, off-price chains such as T.J. Maxx, and dollar stores all muscled onto its turf.

Instead of cultivating its cachet as competition mounted and the economy struggled, Target instead emphasized low prices and unimaginative products. The doubly deadly result: The retailer is no longer winning on style *or* on price.

Target is drawing fewer shoppers. As of December, 37% of Americans had browsed in a Target store or its website in the preceding four weeks, according to data from Kantar Retail. In December 2007 the equivalent figure was 53%. That means millions of shoppers have abandoned Target. Despite the exodus, sales have ticked up during the past few years; Target is on track for $73 billion in 2014. What that means is that the company has become increasingly reliant on its core customers. It needs to attract fresh ones if it wants to reignite its growth.

Then there's the value equation. In December 2007, Target scored a 48.4 on a scale that measures shoppers' sense that they get their money's worth, as compiled by YouGov BrandIndex. As of January 2015, that number had plunged to 31, erasing the company's long-standing edge over rival Wal-Mart.

Those are the disconcerting trends for the long term. Then there were the company's straight-up whiffs. A massive hacking in 2013 enraged customers. The company's subpar web presence left it gasping to catch its rivals. And finally it bungled its expansion into Canada in disastrous fashion.

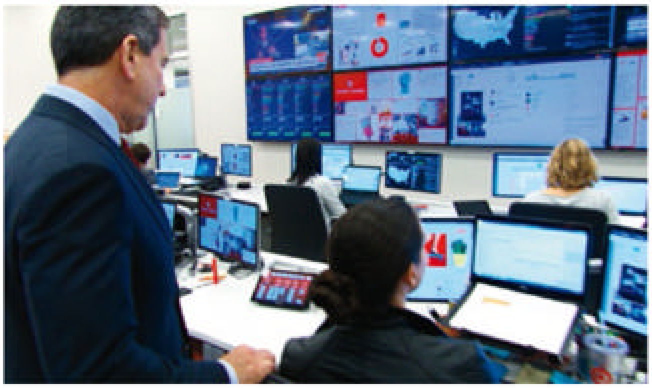
That array of woes has steadily chipped away at Target's profits. Earnings, which peaked at $3.2 billion a decade ago, are expected to be $1.5 billion for 2014. Net income as a percentage of sales has fallen from 4.5% to 2% during the same period, according to S&P Capital IQ, and gross profit margins have slipped.

That's the situation facing Cornell. A former senior PepsiCo executive and CEO of Sam's Club, he has made a name for himself in the retail world with a seemingly contradictory set of traits: He's a dyed-in-the-wool data guy who likes nothing more than nosing around a store and getting a feel for what's going on.

Since taking the reins in August, Cornell, 56, has moved quickly, seeking to speed up Target's metabolism. He aggressively squeezed Amazon and Wal-Mart by offering free shipping for online orders during the holidays. That decision was made in a matter of days rather than the months it would have taken in the past.

The new CEO's most dramatic step so far: He ripped the bandage off Target's Canadian wound, a failed 2013 initiative that left the company bleeding. Closing all its stores north of the border cost $5.4 billion, but it stanched a key source of losses and will help the company concentrate on its U.S. business. Cornell's decisiveness, along with a better-than-expected holiday-season increase in sales at the website and stores open for at least a year, has revived Target's stock: The shares have jumped 30% under the new CEO, to all-time highs.

Cornell knows the plight of retailers that can't adapt, and he's the first to acknowledge that Target has a lot of work ahead. A key element will be improving the company's focus, which is CEO-speak for exiting or paring back certain business lines. "The categories we're going to stand for," he says, "the ones I call our signature categories—they're the ones that can differentiate the brand going forward. So you'll see us elevate our focus around our style categories, apparel, home, beauty—critically important categories for our guest—and we think we can differentiate in that space." He also wants to "localize" Target's product mix. The company plans to



Clockwise: The data-monitoring hub at Target's headquarters; Cornell examines a housewares display; a TargetExpress; food on display inside that outlet.

follow its customers as they move back to cities, with new urban locations that are smaller than its 1,800 big boxes, and stop playing catch-up when it comes to digital.

Most of all, Target knows it needs to recapture its elusive ability to seduce. But as many a retailer (and many a teenager) has learned the hard way, wanting to be cool is a lot easier than actually being cool.

When Cornell arrived at Target's headquarters in Minneapolis, he was installed in the newly redone CEO's corner suite on the 26th floor. Almost immediately he insisted he be moved to a smaller office down the hall that is only steps away from the company's global data nerve center.

That's the company's mission-control-style monitoring room, which it calls "guest central." There a team of 10 staffers scrutinizes live feeds from social media sites such as Pinterest, Facebook, and Twitter, along with television stations, on nine large TV screens high on the wall. They watch intently and use software to aggregate data to gauge by-the-second reactions to a product launch or news announcement or to respond quickly to, say, a customer fulminating on Twitter.

The social command center existed before Cornell became CEO. But he has beefed up its capabilities, and he's looking for creative ways to use the data. He drops in every morning and insists on two updates a day.

Analytics have long been a central part of Cornell's approach. When he headed Sam's Club, the $55-billion-a-year Wal-Mart division, from 2009 to 2012, he improved the unit's customer-insights system, according to Maggie Nation, a marketing executive at Sam's under Cornell. The effort yielded such good results that Wal-Mart had all of its insights teams report directly to Cornell.

Cornell had previously upgraded analytics at Safeway, where he was chief marketing officer from 2004 to 2007. That data helped him ramp up the grocer's successful Lifestyle stores and led him to add higher-end touches like softer lighting, hardwood floors, and sushi bars. Cornell also loved to walk around stores, says Stuart Aitken, who worked under him at two companies. Cornell would grill customers about such minutiae as store lighting and which signs were hard to read. He would often take the clues he gathered in those conversations and use the analytics to look for broader patterns that would reveal problems or opportunities.

Cornell's emphasis on analytics

> **“The truth is, we haven’t kept up,” Target’s interim CEO told the staff in May. “We’ve got to fight harder to give our guests what they want.”**

appealed to Target’s board as it looked for a new CEO, according to the director who oversaw the search, Roxanne Austin, head of Austin Investment Advisors, a private investment and consulting firm. Cornell also boasted a track record of building private-label brands, a priority for Target, and had a reputation as a leader who could rally the troops and change a culture. All of that trumped his inexperience in three areas that will be crucial to determining whether Target can get its mojo back: home goods, e-commerce, and clothing. (Cornell is trying to catch up: He was the first Target CEO to hobnob at New York Fashion Week in September.) “No one else had this set of experiences,” Austin says. “He was the perfect guy.”

Brian Cornell’s childhood was anything but perfect—or easy. His parents split up early, and Cornell was only 6 when he last saw his father, who died young. Cornell’s mother suffered from heart disease through much of her life, and the two of them lived very modestly off her disability check in working-class Whitestone, Queens. Eventually his mother’s health declined to the point that Cornell’s grandparents became his main caregivers. From the age that he could first make himself useful, Cornell says, he did odd jobs in his spare time: shoveling snow, mowing lawns, stacking bricks. “I always had to work to fill in the gaps,” he says.

As a teenager he spent summers cleaning trucks at a Tropicana distribution center near his home. Other retail jobs, along with gigs coaching high school football, helped him pay his way through college at UCLA. (Among the few objects displayed in Cornell’s spare, immaculate office is an autographed UCLA football helmet from fellow alum and Dallas Cowboys legend Troy Aikman inscribed “From one QB to another.”)

“I had to scramble and scratch for everything I have,” says Cornell. Even today, he says, “I probably still wake up every day wanting to make sure I don’t end up battling some of those same things I did when I was a kid,” and adds, “I’m still my toughest critic.” Despite all that, Cornell is approachable and genial, though he listens with an intensity that is almost alarming.

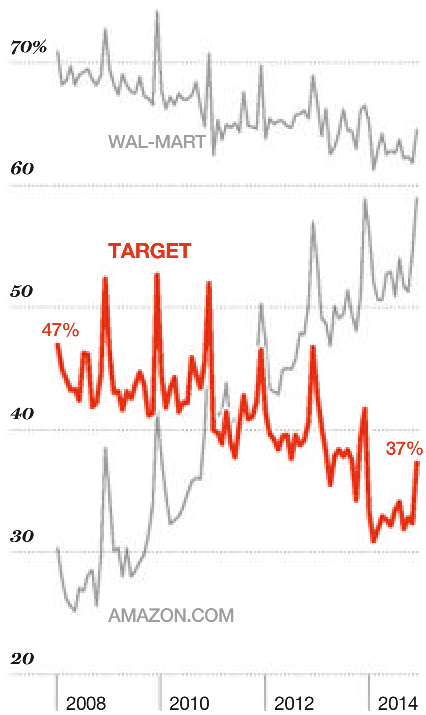
“Intense” also applies to Cornell’s workout regimen. It’s not rare that a CEO would be found every morning at 7 a.m., as Cornell is, in the gym at company headquarters, on the treadmill as he fires off emails from his iPad. What’s unusual is that on most days he returns to the gym for a second session after work. About 15 years ago Cornell attended the “corporate athlete program” at the Human Performance Institute, making him a zealot for optimizing performance not only with exercise but also with adequate sleep.

Cornell isn’t the type who exalts the machismo of outlandish hours. Just the opposite. It’s not unusual for him to inquire about a colleague’s workout habits and make specific recommendations. Laxman Narasimhan, CEO of PepsiCo Latin America Foods, says his former boss would gently chide him to shoot for 200 minutes of exercise a week, extolling the sound mind he said stems from a sound body. He says Cornell encouraged him to take time for fitness on their business trips.

Cornell was always ambitious. But from the outside, he looked like a corporate lifer, spending 20 years ascending inside Tropicana and then its subsequent owner, PepsiCo. But his impatience to land a major CEO position eventually set him in motion. He began hopscotching through a series of senior positions at different companies.

Cornell worked at Safeway from 2004 to 2007 as chief of marketing, as CEO of Michaels Stores from 2007 to 2009, then as CEO of Sam’s Club. At each stop he expanded the chain’s house brands. At Sam’s Club, Cornell helped reverse a sales decline and made it the

Where Americans Shopped in the Past Four Weeks



GRAPHIC SOURCE: KANTAR

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OM • TARGET • WALGREEN CO. • WELLPOINT • JOHNSON & JOHNSON
MERICAN INTERNATIONAL GROUP • STATE FARM • METLIFE • PEPSICO
OMCAST • UNITED TECHNOLOGIES • GOOGLE • CONOCOPHILLIPS •
HEMICAL • CATERPILLAR • UNITED PARCEL SERVICE • PFIZER • LOWE'S
ORPORATION • ENERGY TRANSFER EQUITY • AETNA • COCA-COLA •
ARTIN CORPORATION • BEST BUY • THE WALT DISNEY COMPANY •
SCO • FEDEX • MERCK • SAFEWAY • JOHNSON CONTROLS • INGRAM
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A Target in Toronto in February, weeks after the company announced it was pulling out of Canada

fastest-growing division of Wal-Mart. Cornell was briefly viewed as a contender to succeed Mike Duke but left in part because his wife never cottoned to life in Bentonville, Ark. Cornell returned to PepsiCo in 2012 to head the Americas operations for Frito-Lay and other foods. He was whispered about as a potential PepsiCo CEO. But when Target called, he didn't hesitate. As he puts it, "It's a dream job."

Target's history turns on two well-timed decisions. The first was the realization by Dayton's department store that customers were flocking to the less expensive wares it was selling in its basement. That was the genesis of Target, in 1962, a year that also saw the birth of Wal-Mart, Kmart, and Kohl's. Wal-Mart in particular would cast a shadow over its smaller rival. By the late 1980s its low prices were squeezing Target. That led to the second crucial decision, in the mid-1990s. Target could set itself apart by offering something its rivals didn't: clothing and kitchenware with panache and low prices. (Excellent marketing didn't hurt either.)

By 1999, Target had attained a chic that was nearly inconceivable for a discounter. It launched the first of what have so far been 150 collaborations with leading designers, offering teakettles by renowned architect Michael Graves. Later collections, with Isaac Mizrahi in 2002 and Italian fashion house Missoni in 2011, were smashes, too, and established such offerings as Target's signature strategy.

The Great Recession threw the company off its stride. Being trendy seemed like an indulgence in a time of depressed wages and underemployment. Target's marketing began echoing Wal-Mart's dogma of frugal prices rather than fun and flair. Target cut back the shelf space it was devoting to unique, unproven merchandise—whether it was home goods or clothing—and reduced the quality of some of its apparel to keep costs down. Meanwhile, Macy's, Kohl's, and H&M were imitating the company with their own designer collaborations.

Target was standing out less and less. To generate visits the company added more groceries, but without any distinctive touch to set it apart. By 2013 food, a notoriously low-margin business, had grown to a fifth of its revenue. Target had concentrated too much on the "pay less" part of its mantra and not enough on the "expect more" part.

Then came two epic corporate wipeouts. Target's move into Canada was a fiasco. Rather than launching new stores in carefully selected spots and building slowly, Target acquired 124 locations in 2013 in one fell swoop by buying all the outlets from a defunct discounter called Zellers. Never mind that one of the causes of Zellers' demise was the poor location of its stores. Or that the spaces were designed to enable a different strategy from Target's. Throw in supply-chain problems that yielded empty shelves and high prices, and it added up to an unmitigated disaster.

Then there was a second calamity. In the final days of the 2013 holiday shopping season, Target disclosed that hackers had obtained as many as 70 million customer records. Though such intrusions seem to occur almost daily today, at the time it was the worst retail hacking in history. Customers were livid. They punished Target, and business slowed well into 2014.

By that spring the pressure had built, and something had to give. As often happens, it was the chief executive who gave. In May 2014, Gregg Steinhafel, a superb merchandiser who'd been integral to Target's rise but stiff and cautious as CEO, resigned.

While the confluence of the data breach, the Canadian disaster, and Steinhafel's departure was traumatic, it may have been the shock Target needed. CFO John Mulligan, who was named interim CEO, started a four-month corporate soul-searching effort. "The truth is, we haven't kept up," Mulligan told staff in an email on May 6, the day after Steinhafel left. "We've got to fight harder to give our guests what they want."

Target intensified efforts to improve its second-rate website. Its capabilities had fallen behind those of Wal-Mart, which had the capacity to use a big chunk of its stores to help fill online orders a year before Target did. The

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company rewrote three-quarters of the code for its website and has now caught up to, or even surpassed, some rivals. Target's Cartwheel coupon-tracking app is now considered an industry leader, downloaded 13 million times, and has generated $1 billion in sales so far.

Under Mulligan, Target took symbolic yet practical steps, such as consolidating its top executives on the 26th floor of its headquarters to make it easier to talk to one another. Target relaxed its dress code last March, elating the staff by leaving sartorial decisions largely to common sense. (Even in the company's most formal days, there was a standing exemption for any shirt in Target's signature red worn with khakis.)

Cornell has loosened the atmosphere in other ways. He eats in the company cafeteria, where he mingles with staff. He opened Target's annual fall meeting to the press for the first time. The company has set up a lounge on the executive floor where employees can check out what merchandise is in the pipeline and swap ideas in a relaxed environment. And the company, long populated by lifers, is redoubling efforts to recruit outsiders with fresh ideas.

"It's not that we *became* insular. We *were* insular," says Jeff Jones, Target's marketing boss. "If you need to go faster, you need people who've done it. We didn't have enough people who'd done it before."

Cornell certainly qualifies as an outsider, and his resolution of the Canada question showed the speed of his decision-making. The fate of the operations was sealed when the CEO made a solo journey to some Montreal-area stores the Saturday before Christmas, the busiest day of the season in retail. As Cornell wandered among the empty aisles, he peppered his CFO with texts. He concluded that painful as it was to admit, it would take too much time and treasure to fix the Canadian operation. Less than three weeks later Target announced it was shuttering all its stores there.

It's early February and Cornell is back in a Target again. As he strides through its outlet in northeast Minneapolis, which doubles as its "living lab," he points out how Target is displaying its kitchenware. Rather than plates, mats, and utensils stocked separately, they are presented together in realistic kitchen and table settings. The idea is to help customers imagine mixing and matching items in the way that countless retailers have been doing for decades.

It seems symbolic. The CEO is a whirl of ideas and initiatives, but most of them appear incremental and one or another of its rivals has some version of most of them. For example, Target is trying out a new "first impressions" area at the front of a few stores, looking to highlight choice items, such as an elegant soup bowl, in an appealing presentation. It would be a step up from the bins with $1 tchotchkes that currently welcome shoppers. And Target is taking electronics like iPads out of glass cases so that customers can try them out. (One plan that seems more unusual: Target is testing a service in which a brand-agnostic staffer will offer advice to parents of infants. The baby and maternity category is essential to capturing the next generation of shoppers, he says, and defines a group that visits Target stores most often.)

Cornell acknowledges that "there's nothing we're talking about where someone's going to say, 'Wow, I've never seen that before.'" But, he says, "from a Target standpoint, they've never seen us bundle these key initiatives." And, he argues, "they will add up to a very bold change for the brand and the business ... If we execute the plan over the next few years, you will say, 'Boy, Target made a huge transformation.'" He's giving himself and his team three years to deliver.

The CEO plans to focus on categories in which Target believes it can win and trim elsewhere. (In February, for example, he pulled the plug on Target's video-streaming service.) That means more store brands. Cornell's Safeway experience is instructive. Early to see the opportunity in organic foods, he was the architect of the grocer's O Organics brand, which took off. Today, mere months after the moms in the Dallas store told him they wanted more organic foods for their babies, Cornell has a goal: He wants organic items to account for 60% of the company's baby food sales within two years, up from 40% now. That would address a key challenge: to make Target's food selection more distinctive.

Cornell is likely to accelerate Target's roll out of its smaller outlets, such as its 100,000-square-foot CityTarget stores aimed at urban consumers. The company is also experimenting with highly customized 20,000-square-foot TargetExpress neighborhood mini-stores, the second of which will open next month in the Bay Area. Of course, Wal-Mart already has 700 small-format (primarily grocery) stores. Walgreens now sells fresh food in many stores, and even Family Dollar is improving its selection. And outside of the food aisles, other retailers and department stores are still on the hunt for the hip-and-cheap sweet spot.

So is Cornell. In November, Target collaborated with Story, a trendy boutique in New York City's Chelsea that creates a new theme every month and changes the look and merchandise accordingly. Just six weeks elapsed from the time Cornell first showed up at Story in September, introducing himself as "Brian from Target," to the opening. In the old days that would've taken many months. Story spotlighted Target brands like Archer Farms, as well as some exclusive products by TOMS and Nate Berkus. It was a way for Target, and Cornell, to keep a finger on the pulse of what's cool.

Should the CEO personally be leading the search for the next hit teakettle? Maybe not. The company may or may not succeed at luring new customers. But Cornell will surely be one of the first to know. He'll be in the aisles, finding out for himself.

FEEDBACK *Phil.Wahba@fortune.com*

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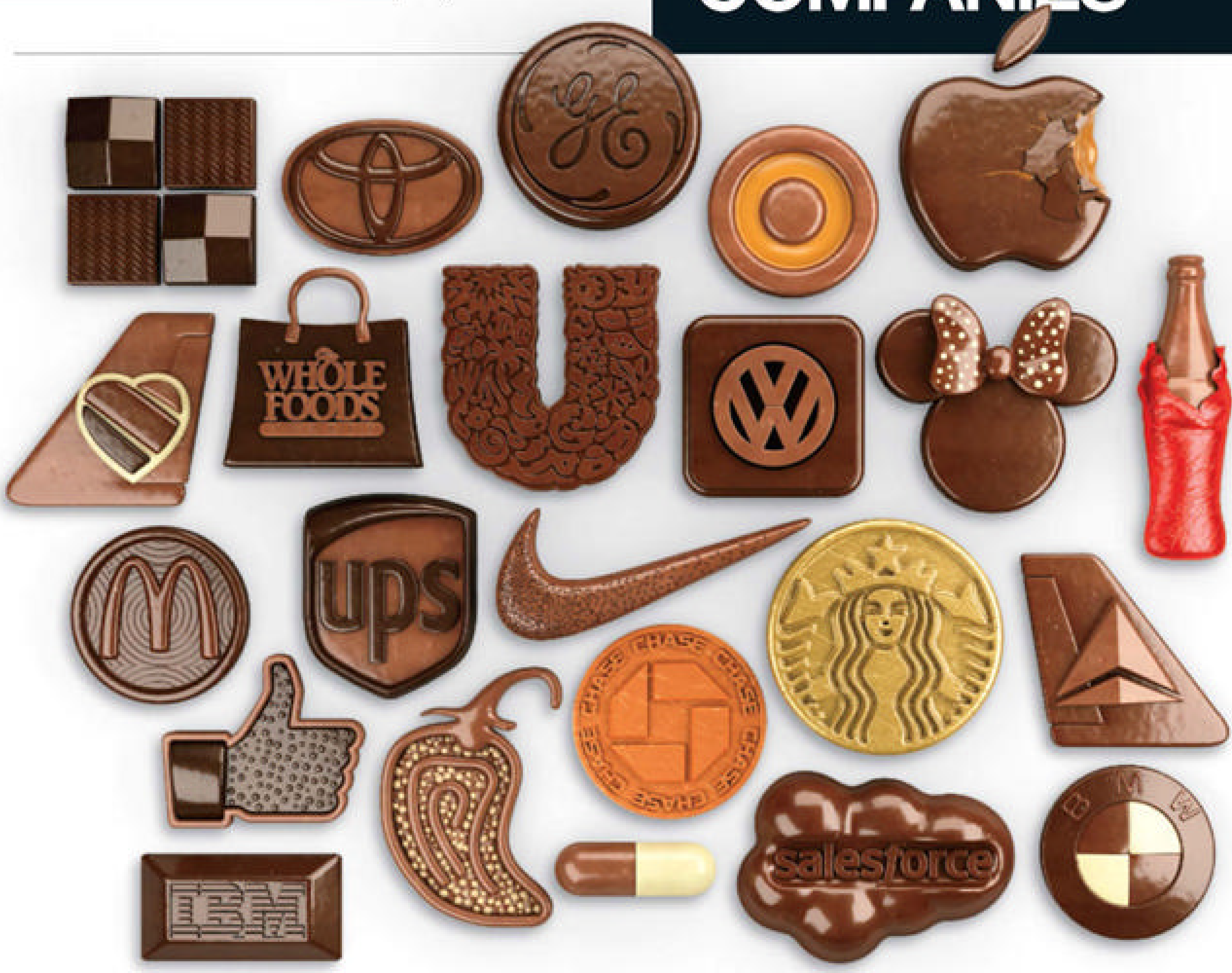

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What becomes a reputation most? Healthy financials and stock performance, for starters. This year four companies have landed on the 50 All-Stars for the first time—Chipotle, CVS Health, Salesforce.com, and the financial services giant USAA, which at No. 28 is this year's strongest debut. But not all companies fared as well. Consumer criticism and a change in leadership caused McDonald's to slip to No. 46, its lowest rank in the seven years it has appeared in the top 50, and a hacking scandal and public stumbles resulted in Target's dropping to No. 48. (Read about the retailer's efforts to bounce back in this issue.) For the latest trends, company snapshots, and more rankings, visit fortune.com/WMAC.
—*Christopher Tkaczyk*

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Consulting

THE 50 ALL-STARS

1	APPLE	(2013 RANK: 1)	26	FACEBOOK	(38)
2	GOOGLE	(3)	27	BOEING	(26)
3	BERKSHIRE HATHAWAY	(4)	28*	USAA	(—)
4	AMAZON.COM	(2)	28*	CATERPILLAR	(33*)
5	STARBUCKS	(5)	30	SAMSUNG ELECTRONICS	(21)
6	WALT DISNEY	(7)	31	BLACKROCK	(41)
7	SOUTHWEST AIRLINES	(9)	32	EXXON MOBIL	(27)
8	AMERICAN EXPRESS	(11)	33	NESTLÉ	(31)
9	GENERAL ELECTRIC	(10)	34	UPS	(32)
10	COCA-COLA	(6)	35	J.P. MORGAN CHASE	(30)
11	JOHNSON & JOHNSON	(19)	36	UNILEVER	(37)
12	FEDEX	(8)	37	MARRIOTT INTL.	(39)
13	NIKE	(13)	38	WAL-MART STORES	(28)
14	NORDSTROM	(17)	39	DELTA AIR LINES	(48)
15	BMW	(14)	40	INTEL	(47)
16	COSTCO WHOLESALE	(12)	41*	PEPSICO	(42)
17	PROCTER & GAMBLE	(15)	41*	HOME DEPOT	(40)
18	WHOLE FOODS MARKET	(20)	43	VOLKSWAGEN	(36)
19	SINGAPORE AIRLINES	(18)	44	CHIPOTLE MEXICAN GRILL	(—)
20	MICROSOFT	(24)	45	CVS HEALTH†	(—)
21	3M	(23)	46	MCDONALD'S	(22)
22	WELLS FARGO	(35)	47	AT&T	(50)
23	GOLDMAN SACHS GROUP	(33*)	48	TARGET	(29)
24	TOYOTA MOTOR	(25)	49	ACCENTURE	(45)
25	IBM	(16)	50	SALESFORCE.COM	(—)

DROPPED OUT OF THIS YEAR'S TOP 50
DUPONT (43); EBAY (44); DEERE (46); CISCO SYSTEMS (49)

INDUSTRY STARS

Computers and Communication

COMPUTER SOFTWARE
1. Salesforce.com (1)
2. Intuit (3)
3. Adobe Systems (2)
4. Microsoft (4)
5. SAP (7)
6. Autodesk (6)

INFORMATION TECHNOLOGY SERVICES
1. Accenture (1)
2. IBM (2)
3. Booz Allen Hamilton Holding (4)
4. Cognizant Technology Solutions (3)
5. Xerox (5)
6. CACI International (6)
7. Science Applications International (—)

CABLE AND SATELLITE PROVIDERS
1. Comcast (1)
2. Liberty Global (2)
3. DirecTV (3)
4. Dish Network (5)

NETWORK AND OTHER COMMUNICATIONS EQUIPMENT
1. Cisco Systems (2)
2. Qualcomm (1)
3. Motorola Solutions (3)
4.* Corning (4)
4.* L.M. Ericsson (6)
6. Juniper Networks (7)
7. Harris (5)
8. Nokia (8)

COMPUTERS
1. Apple (1)
2. EMC (2)
3. Fujitsu (7)
4. Lenovo Group (3)
5. Seagate Technology (4)
6. Asustek Computer (—)
7. Canon (6)
8. Western Digital (5)

INTERNET SERVICES AND RETAILING
1. Google (1)
2. Facebook (3)
3. Amazon.com (2)
4. Priceline Group[1] (4)
5. Expedia (7)
6. IAC/InterActiveCorp (8)

TELE-COMMUNICATIONS
1. AT&T (4)
2. Verizon Communications (1)
3. Telefónica (2)
4. Vodafone (5)
5. SoftBank (9)
6. Deutsche Telekom (7)
7. Nippon Telegraph & Telephone (8)
8.* Vivendi (11)
8.* Orange (12)
8.* América Móvil (6)

*TIE IN RANK.
†CHANGED NAME FROM CVS CAREMARK.

QUALITY OF PRODUCTS	1. Nordstrom 2. Walt Disney 3. Amazon.com	INNOVATION	1. Apple 2. Google 3. Walt Disney
QUALITY OF MANAGEMENT	1. Walt Disney 2. U.S. Bancorp 3. Wells Fargo	LONG-TERM INVESTMENT VALUE	1. Walt Disney 2. Nestlé 3. Google

THE MOST REPUTABLE COMPANIES, AS RANKED BY THEIR PEERS

Consumer Products

BEVERAGES
1. **Coca-Cola** (1)
2. Anheuser-Busch InBev (2)
3. Coca-Cola Enterprises (5)
4. Diageo (3)
5. Keurig Green Mountain[2] (11)
6. Heineken Holding (6)
7. Suntory (8)
8. Dr Pepper Snapple Group (9)

APPAREL
1. **Nike** (2)
2. VF (3)
3. Ralph Lauren (1)
4. PVH (7)
5. Levi Strauss (5)

CONSUMER FOOD PRODUCTS
1. **Nestlé** (1)
2. Unilever (2)
3. PepsiCo (3)
4. Danone (4)
5. General Mills (5)
6. Mondelez International (8*)

FOOD PRODUCTION
1. **Archer Daniels Midland** (3)
2. Ingredion (1)
3. Bunge (4)
4. Tyson Foods (6)
5. Wilmar International (2)
6. Sanderson Farms (10)

HOME EQUIPMENT, FURNISHINGS
1. **Whirlpool** (1)
2. Fortune Brands Home & Security (3)
3. Tupperware Brands (2)
4. Stanley Black & Decker (5)
5. Steelcase (4)
6. Leggett & Platt (6)

SOAPS AND COSMETICS
1. **Procter & Gamble** (1)
2. L'Oréal (2)
3. Colgate-Palmolive (3)
4. Estée Lauder (4)
5. Kimberly-Clark (5)
6. Henkel (9)

Contracted Services

DIVERSIFIED OUTSOURCING SERVICES
1.* **Robert Half International** (2)[3]
1.* **Towers Watson** (2)
3. ManpowerGroup (1)[3]
4. Cintas (1)
5. Sodexo (5)

HEALTH CARE: INSURANCE AND MANAGED CARE
1. **UnitedHealth Group** (1)
2. Aetna (2)
3. Humana (4)
4. Cigna (6)
5. Anthem[4] (3)

HEALTH CARE: MEDICAL FACILITIES
1. **HCA** (3)
2. Universal Health Services (2)
3. DaVita HealthCare Partners (1)
4. Fresenius (6)
5. Community Health Systems (7)

HEALTH CARE: PHARMACY AND OTHER SERVICES[5]
1. **Cerner** (—)
2. Team Health Holdings (—)
3. Quintiles Transnational Holdings (—)
4. Covance (—)
5. Quest Diagnostics (—)

Financials

INSURANCE: PROPERTY AND CASUALTY
1. **Berkshire Hathaway** (1)
2. USAA (3)
3. Travelers Cos. (5)
4. State Farm Insurance (6)
5. American International Group (13)
6. Swiss Re (—)
7. Allstate (8)
8. Allianz (4)
9. Zurich Insurance Group (7)

FINANCIAL DATA SERVICES
1. **Automatic Data Processing** (1)
2. Thomson Reuters (2)
3. Broadridge Financial Solutions (9)
4. Paychex (4)
5. Fiserv (5)

CONSUMER CREDIT CARD AND RELATED SERVICES
1. **American Express** (1)
2. Visa (3)
3. MasterCard (2)
4. Capital One Financial (6)
5. Discover Financial Services (4)

INSURANCE: LIFE AND HEALTH
1. **MetLife** (2)
2. Northwestern Mutual (7)
3. Prudential Financial (3)
4. New York Life Insurance (6)
5. Aflac (1)
6. TIAA-CREF (3)

MEGABANKS
1. **Goldman Sachs Group** (3)
2. Wells Fargo (1)
3. J.P. Morgan Chase (2)
4. Toronto-Dominion Bank (4)
5. Royal Bank of Canada (5)
6. Citigroup (9)
7. HSBC Holdings (6)
8. Bank of America (10)

SECURITIES/ ASSET MANAGEMENT
1. **BlackRock** (1)
2. T. Rowe Price (2)
3. Charles Schwab (3)
4. Carlyle Group (5)
5. Franklin Resources (4)
6. Jones Financial (Edward Jones) (7)

SUPER-REGIONAL BANKS
1. **U.S. Bancorp** (1)
2. PNC Financial Services Group (3*)
3. Northern Trust Corp. (3*)
4. Bank of New York Mellon (2)
5. State Street Corp. (5)
6. BB&T Corp. (6)

NOTES: A DASH IN PRIOR YEAR'S RANK MEANS COMPANY WAS NOT IN THE SURVEY LAST YEAR. *TIE IN RANK. [1]CHANGED NAME FROM PRICELINE.COM. [2]CHANGED NAME FROM GREEN MOUNTAIN COFFEE ROASTERS. [3]RANK IN TEMPORARY HELP LAST YEAR. [4]CHANGED NAME FROM WELLPOINT. [5]NO PRIOR YEAR RANKS. INDUSTRY RESULTS WERE NOT PUBLISHED LAST YEAR BECAUSE OF AN INSUFFICIENT RESPONSE RATE.

TALENT ATTRACTION	1. Goldman Sachs 2. Google 3. Facebook
FINANCIAL SOUNDNESS	1. Google 2. Comcast 3. Apple
CORPORATE ASSET USE	1. Walt Disney 2.* Costco 2.* Wells Fargo
SOCIAL RESPONSIBILITY	1. Walt Disney 2. Whole Foods Market 3. Nestlé

Media and Entertainment

ENTERTAINMENT

1. **Walt Disney** (1)
2.* Netflix (6)[6]
2.* Discovery Communications (2)
4.* Viacom (3)
4.* Twenty-First Century Fox (4)
6. Time Warner (5)

HOTELS, CASINOS, RESORTS

1. **Marriott International** (1)
2. Hilton Worldwide Holdings (—)
3. Wynn Resorts (3)
4. Hyatt Hotels (5)
5. Starwood Hotels & Resorts (2)
6. InterContinental Hotels Group (4)
7. Las Vegas Sands (6)

Natural Resources

CHEMICALS

1. **Monsanto** (2)
2. Ecolab (—)
3.* Bayer (4)
3.* BASF (1)
5. PPG Industries (3)

METALS

1. **Alcoa** (1)
2. Nippon Steel & Sumitomo Metal (2)
3. POSCO (6)
4. Tata Steel (4)
5. ArcelorMittal (3)
6. ThyssenKrupp (10)
7. Baosteel Group (7)
8. JFE Holdings (5)
9. China Minmetals (9)

MINING, CRUDE-OIL PRODUCTION

1. **Occidental Petroleum** (1)
2. ConocoPhillips (2)
3. BHP Billiton (4)
4. Apache (3)
5. Ecopetrol (6)
6. Rio Tinto (9)
7. Freeport-McMoRan[7] (8)
8. China National Offshore Oil (9)

PACKAGING, CONTAINERS

1. **Sealed Air** (1)
2. International Paper (1)[8]
3. Bemis (3)
4. Rock-Tenn (2)
5. MeadWestvaco (9)
6. Ball (4)

PHARMACEUTICALS

1. **Johnson & Johnson** (1)
2. Novartis (3)
3. Roche Group (2)
4. Bristol-Myers Squibb (4)
5. Merck (7)
6. Amgen (5)
7. AbbVie (8)
8. GlaxoSmithKline (6)

Power

ENERGY: U.S.[9]

1. **Williams** (—)
2. Adams Resources & Energy (—)
3. NRG Energy (—)
4. UGI (—)
5. New Jersey Resources (—)

ELECTRIC AND GAS UTILITIES

1. **Dominion Resources** (2)
2. NextEra Energy (1)
3. Southern Co. (3)
4. Sempra Energy (—)
5. American Electric Power (7)
6. Exelon (9)
7. Duke Energy (6)
8. Xcel Energy (5)

PETROLEUM REFINING

1. **Exxon Mobil** (1)
2. Chevron (3)
3. Royal Dutch Shell (2)
4. Valero Energy (5)
5. Statoil (4)
6. Phillips 66 (7)
7. Total (6)
8. BP (8)

NOTES: A DASH IN PRIOR YEAR'S RANK MEANS COMPANY WAS NOT IN THE SURVEY LAST YEAR. *TIE IN RANK. [6]RANK IN INTERNET SERVICES AND RETAILING LAST YEAR. [7]CHANGED NAME FROM FREEPORT-MCMORAN COPPER & GOLD. [8]RANK IN FOREST AND PAPER PRODUCTS LAST YEAR. [9]REPLACES THE INTERNATIONAL ENERGY INDUSTRY. [10]RANK IN AEROSPACE AND DEFENSE LAST YEAR. [11]CHANGED NAME FROM AECOM TECHNOLOGY. [12]INDUSTRY RETURNS TO THE SURVEY. HAS NOT APPEARED SINCE 2011. [13]CHANGED NAME FROM CVS CAREMARK. [14]REORGANIZED INTO A HOLDING COMPANY AND CHANGED NAME FROM WALGREEN.

Precision

ELECTRONICS

1. **General Electric** (1)
2. Samsung Electronics (2)
3. Honeywell International (5)[10]
4. Siemens (3)
5. Emerson Electric (4)
6. Royal Philips (5)
7. Schneider Electric (7)
8. Mitsubishi Electric (13)
9. LG Electronics (8)

MEDICAL PRODUCTS AND EQUIPMENT

1. **Abbott Laboratories** (1)
2. 3M (2)
3. St. Jude Medical (5)
4. Becton Dickinson (7)
5. Zimmer Holdings (8)
6. Stryker (4)

SEMI-CONDUCTORS

1. **Intel** (1)
2. Texas Instruments (2)
3. Applied Materials (5)
4. Taiwan Semiconductor Manufacturing (3)
5. Broadcom (4)
6. Micron Technology (8)
7. SanDisk (7)
8. STMicroelectronics (9)

Shelter

HOME-BUILDERS[12]

1. **Toll Brothers** (—)
2. Lennar (—)
3. Standard Pacific (—)
4. NVR (—)
5. D.R. Horton (—)

ENGINEERING, CONSTRUCTION

1. **Fluor** (1)
2. Jacobs Engineering Group (2)
3. Peter Kiewit Sons' (3)
4. EMCOR Group (5)
5. AECOM[11] (6)

REAL ESTATE

1. **Simon Property Group** (1)
2. Jones Lang LaSalle (8)
3. CBRE Group (2)
4. Equity Residential (4)
5. Host Hotels & Resorts (5)

Stores and Distributors

FOOD AND DRUG STORES

1. **Whole Foods Market** (1)
2. Publix Super Markets (2)
3. CVS Health[13] (3)
4. Kroger (4)
5. Walgreens Boots Alliance[14] (5)
6. Royal Ahold (7)

FOOD SERVICES

1. **Starbucks** (1)
2. Yum Brands (4)
3. Chipotle Mexican Grill (3)
4. McDonald's (2)
5. Panera Bread (5)

GENERAL MERCHANDISERS

1. **Nordstrom** (1)
2. Target (2)
3. Wal-Mart Stores (3)
4. Macy's (4*)
5. Dollar General (4*)

SPECIALTY RETAILERS

1. **Costco Wholesale** (1)
2. Home Depot (2)
3. TJX (5)
4. L Brands (7)
5. AutoZone (6)
6. Lowe's (3)
7. Gap (4)
8. Staples (8)

WHOLESALERS: DIVERSIFIED

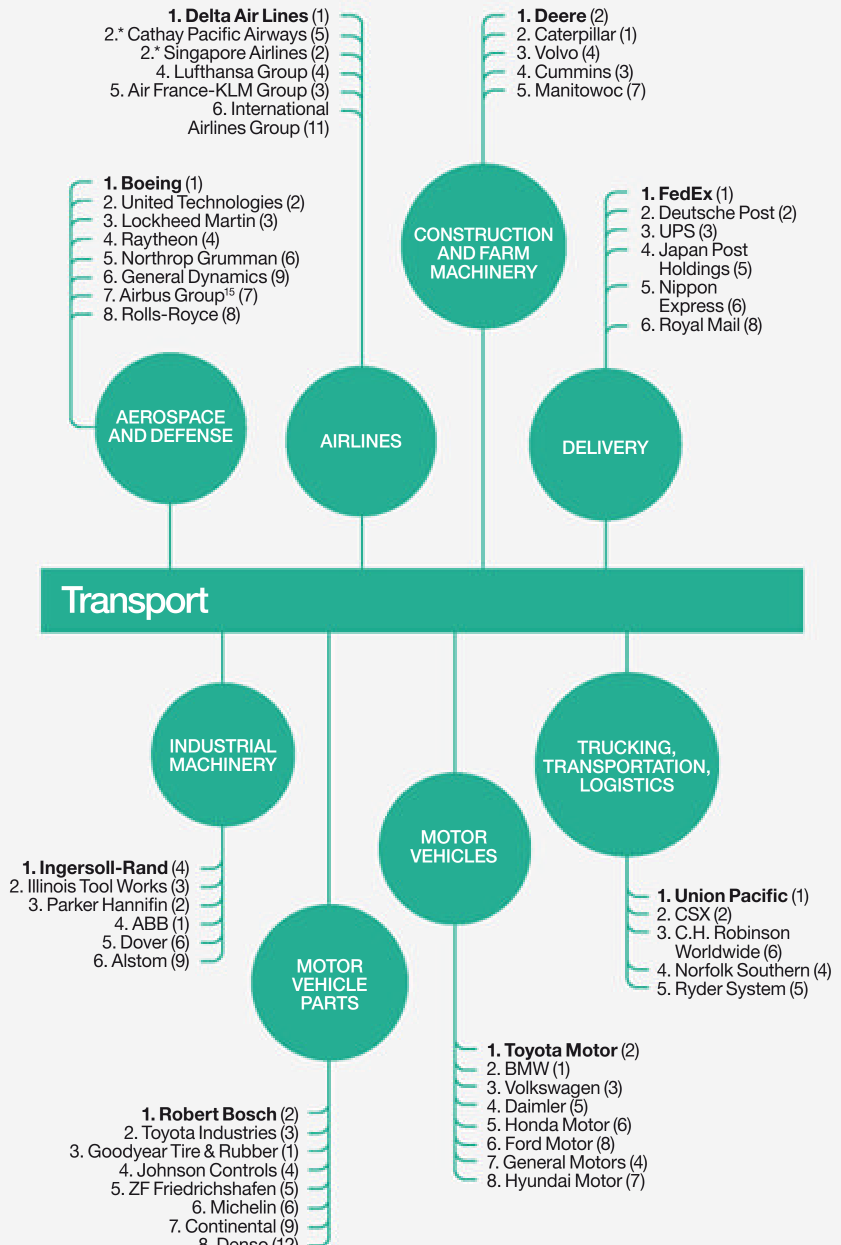
1. **W.W. Grainger** (1)
2. Graybar Electric (2)
3. Rexel (3)
4. Genuine Parts (4)
5. Airgas (—)
6. Wolseley (7)

WHOLESALERS: HEALTH CARE

1. **Henry Schein** (1)
2. McKesson (2)
3. AmerisourceBergen (3)
4. Cardinal Health (5)

WHOLESALERS: ELECTRONICS AND OFFICE EQUIPMENT

1. **Arrow Electronics** (1)
2. Avnet (2)
3. Ingram Micro (3)
4. Tech Data (4)



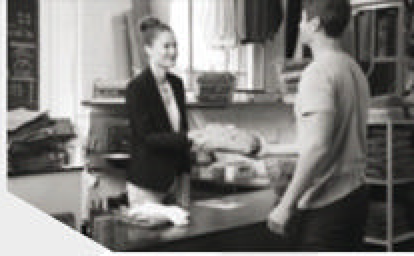
NOTE: [15]CHANGED NAME FROM EADS.

HOW WE DETERMINE THE LIST

The Most Admired list is the definitive report card on corporate reputations. Our survey partners at Hay Group started with approximately 1,400 companies: the *Fortune* 1,000—the 1,000 largest U.S. companies ranked by revenue and non-U.S. companies in *Fortune*'s Global 500 database with revenues of $10 billion or more. Hay then selected the 15 largest for each international industry and the 10 largest for each U.S. industry, surveying a total of 668 companies from 29 countries. To create the 55 industry lists, Hay asked executives, directors, and analysts to rate companies in their own industry on nine criteria, from investment value to social responsibility. A company's score must rank in the top half of its industry survey to be listed.

Because of the distribution of responses, only the aggregate industry scores and ranks are published in Energy: U.S.; Mining, Crude-Oil Production; Petroleum Refining; and Wholesalers: Diversified. Because of an insufficient response rate, the results for companies in the Pipelines industry are not reported.

To arrive at the top 50 Most Admired Companies overall, the Hay Group asked 4,104 executives, directors, and securities analysts who had responded to the industry surveys to select the 10 companies they admired most. They chose from a list made up of the companies that ranked in the top 25% in last year's surveys, plus those that finished in the top 20% of their industry. Anyone could vote for any company in any industry. The difference in the voting rolls is why some results can seem anomalous. For example, Southwest Airlines ranks No. 7 on the overall Most Admired list, far ahead of No. 39 Delta Air Lines. But within the airline category, based on experts' responses, Delta leads the ranking for the third consecutive year, and Southwest Airlines missed the Most Admired cut by ranking in the bottom half of the industry.



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- LOW COST PER PRINT
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YOURS TO MAKE

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FORTUNE WORLD'S MOST ADMIRED COMPANIES

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COMPANY SPOTLIGHT

FISERV

FISERV BRINGS SPEED AND SERVICE TO FINANCIAL TECHNOLOGY

"Having the right technology enables financial institutions to serve customers better, because it enables them to *know* their customers better."

JEFFERY W. YABUKI
PRESIDENT AND CEO

Fiserv is a transformative force in financial services, with more than 30 years of experience developing innovative solutions to meet the ever-changing demands of businesses and consumers.

WHILE THE DIGITAL revolution has helped business immeasurably, it has also created a new challenge: How do you anticipate and serve the needs of customers whose lives move so quickly? This is especially true for the financial services industry, which is in the midst of a top-to-bottom transformation fueled by changing expectations and new technologies.

For Fiserv, delivering a superior user experience while enabling money and information to move quickly, safely and reliably, is key to helping its 14,500 clients worldwide keep pace. Fiserv also understands it's critical for its clients to meet their customers where they are—with solutions and expertise that enhance the way people live and work today.

"Technology in the financial services industry is rapidly moving from business enabler to the core business itself," says Fiserv president and CEO Jeffery W. Yabuki. "Even if the primary interaction a customer has with their financial institution today is through a small screen, technology can be used to make that relationship a personal one. Having the right technology enables financial institutions to serve customers better, because it enables them to *know* their customers better."

Fiserv has grown by leaps and bounds over the last 30 years, from 350 employees and $21 million in revenue in 1984, to 21,000 employees and more than $5 billion in revenue today. Size and scale are important, but speed and innovation matter most. "The world is moving fast," says Yabuki. "Financial institutions that are reimagining the financial experience to deliver what consumers want will be very well positioned to grow new and existing customer relationships."

Fiserv is at the cutting edge of increasing the speed of payments and transactions. Late last year, Fiserv announced the creation of its NOW Network, which is designed to make payments faster, easier and smarter. The NOW Network helps take the 55 billion payments that occur outside the point of sale each year into the digital era, connecting people with everyone they want to pay, when they want to pay them.

Fiserv sees technology as a conduit for information and a mechanism for the delivery of a great customer touch-point, all at the speed of the user's choice. "We help financial institutions differentiate through a winning customer experience," says Yabuki.

FORTUNE
WORLD'S MOST ADMIRED COMPANIES 2015

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ZTE
SMARTISAN
HUAWEI
LENOVO

ENTER THE DRAGONS

ILLUSTRATION BY CHARIS TSEVIS

Almost overnight China's phone-makers came to dominate their own market. Now they're looking farther afield—with claws out.

BY SCOTT CENDROWSKI

LOUD, PROUD, AND WITH PHONES THAT ELICIT A "WOW": THE LATEST SMARTPHONE SUCCESS STORY FROM CHINA IS SHENZHEN'S ONEPLUS.

THE AIR

IS ELECTRIC INSIDE THE STARK-WHITE modernist lobby of OnePlus. Pods of murmuring guests shuffle across the floor as a pair of receptionists, clearly overwhelmed, type furiously at their desks. It's 11 a.m. on a Saturday. This level of activity is not the norm for a corporate building in downtown Shenzhen, China's fifth-largest city. For OnePlus, a young electronics company that expects to sell a staggering 1 million smartphones in its first year, it's business as usual.

The company was founded by 40-year-old Pete Lau and 25-year-old Carl Pei, who decamped from a top Chinese phonemaker, Oppo, just four subway stops down the road. The pair quit to start their own shop, with plans to sell a single $300 phone. It seemed foolhardy. "Thirty thousand smartphones sold was to not get fired," says Pei, who is the company's director of global efforts. "Fifty thousand was acceptable. One hundred thousand was a dream. Now we're trending toward 1 million."

The nearly overnight success of OnePlus may at first appear extraordinary, but it's only the latest chapter in a story that has been years in the making. Low-priced, high-tech mobile phones have become objects of desire for many of the 1.36 billion people in China, even though income per capita—after adjusting for purchasing power—is less than a fourth that of the U.S. In 2012, China passed the U.S. as the world's largest smartphone market. Since then its number of annual phone shipments has doubled, to about 400 million—enough for every man, woman, and child in the U.S. and Canada with tens of millions to spare.

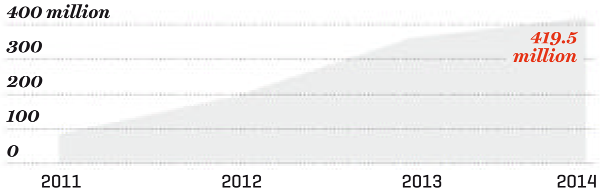
Samsung and Apple, the global leaders in mobile phones, have made no secret of their desire to command the world's largest smartphone market. But

PREVIOUS SPREAD, ORIGINAL PHOTO: DANIEL RÖNNEBERG—ISTOCKPHOTO.COM

“Thirty thousand smartphones sold was to not get fired.”

—CARL PEI, director of global, OnePlus

CHINA’S SMARTPHONE MARKET (ANNUAL NUMBER OF UNITS SHIPPED)



SOURCE: CANALYS ESTIMATES

THE CHINESE ARE ON THE MOVE. FROM TOP: ZTE SPONSORS NBA TEAMS; HUAWEI SHINES AT THE CONSUMER ELECTRONICS SHOW.

FROM TOP: PICHI CHUANG—REUTERS; ROBYN BECK—AFP/GETTY IMAGES

as demand exploded in the country, local companies sprang up to meet it. “Now you see the proliferation of 400 brands in China,” says Neil Shah, a director at Counterpoint Research. “It’s a gold rush.”

In 2011 just two of the top 10 smartphone makers in China were Chinese, according to market researcher Canalys: Huawei and Lenovo. In 2014 eight of the top 10 were Chinese; Samsung and Apple were the only foreign holdouts. In just three years the cast of leaders completely reshuffled as China’s smartphone market more than quadrupled. Today six of the top 10 smartphone brands worldwide are Chinese, according to Strategy Analytics, even though many of them sell only in China—proof of the enormousness of that market relative to the rest of the world.

China’s newcomers are now looking to expand beyond its borders. Xiaomi, a Beijing startup valued at $45 billion, is plowing money and people into nearby India. ZTE, in Shenzhen, revealed plans to double its market share in three years in the U.S. Huawei, also in Shenzhen, traveled to the IFA electronics trade show in Berlin to unveil its newest flagship phone, the Ascend Mate7. In almost every corner of the globe, Chinese phonemakers are present and ready to make a sale.

“China is one of the important global markets, but overseas revenue will occupy more than 70% of the total smartphone business,” says Lv Qianhao, ZTE’s head of handset strategy, citing common industry estimates. “That’s what we will target.”

We’ve seen this film before. In the 1970s electronics from companies in rapidly industrializing Japan flooded Western markets. Goods from Sony, Matsushita, Sanyo, Sharp, and others first imitated and undercut, then improved upon and outmuscled products from domestic manufacturers like RCA, GE, and Zenith. In the 2000s, gadgets from South Korean makers—Samsung, Hyundai, LG—repeated the exercise on their Japanese forerunners: undercut on price, outpace with innovation, profit.

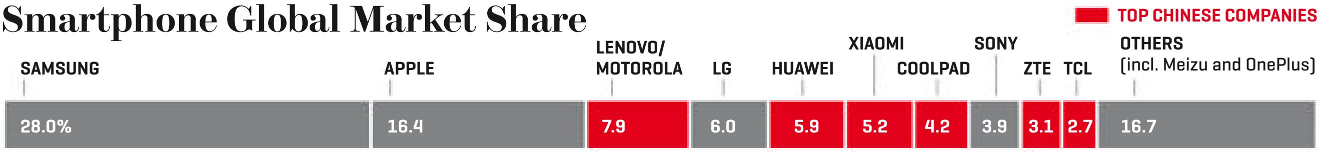
For years Chinese phonemakers served in the shadows as manufacturers for Nokia and others. Everything changed after Google introduced Android in 2008. The inexpensive and customizable mobile operating system, an answer to Apple’s status-quo-shattering iPhone, made it possible for any electronics company with some savvy to develop a worthy alternative. In no time Chinese companies shifted their strategies from churning out white-label devices for others to building brands for themselves.

We are now facing a new era in consumer electronics, a Chinese era, studded with a new generation of wily entrepreneurs and clever engineers armed with lessons learned from those that came before. Yes, some copy Western ideas, sometimes to a T. (Nearly everyone wears black onstage in emulation of Steve Jobs.) But many are genuinely innovating as they race to become the next Nokia of the ’90s: affordable, high tech, global.

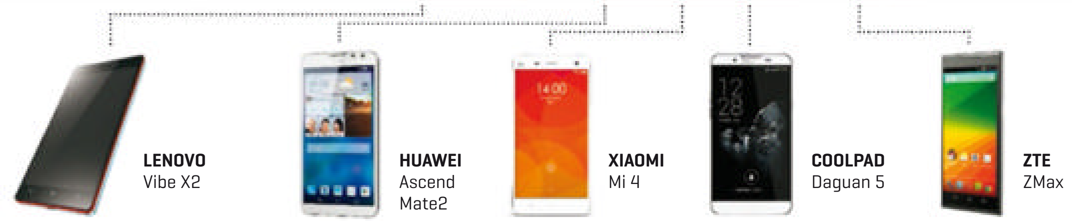
Says Richard Liu, managing director at Morningside Venture Capital in Shanghai and an early Xiaomi investor: “This is probably just the beginning of the wave.”

Meizu was the first Chinese phonemaker to emerge as a brand in its own right. Based in Zhuhai, a leafy coastal city near Hong Kong, Meizu is led by Jack Wong, a high school dropout and onetime factory worker who is often described as temperamental and reclusive. With no marketing budget, Wong used the power of online buzz—he was a frequent presence in

Smartphone Global Market Share



POWER PLAY
A win in China translates to a top showing on the world stage. Here, a selection of Chinese models.



web forums—to create one of China's most popular MP3 players in the 2000s.

Four days after Apple introduced its iPhone in 2007, Wong boasted that Meizu would build an iPhone killer called the M8. The phone turned out to be too much like Apple's distinctive device, and Meizu, under pressure from its muse, pulled it from stores. But Wong's company managed to create millions of fans and put a Chinese smartphone on the map.

Today Meizu is trying to expand within China to better position itself for entry into other Asian markets. Though the company builds some of the best-reviewed smartphones in China, it remains outside the country's top 10 brands. In a cramped conference room in Meizu's headquarters last summer, marketers Arnold Pei and Gaven Zhang outline a new strategy. Arnold scribbles on a whiteboard:

2013 USED TO BE:
1. one cellphone
2. 2,500 RMB ($400)
3. profit first
4. family business held by Jack Wong

2014 GOING TO BE ABOUT:
1. four cellphones
2. sell 1,000–3,000 RMB ($160–$480)
3. market share first
4. hire a lot of people
5. move from hardware company to mobile Internet company

The most important part of Meizu's strategy is the shift in focus from profits to market share. "The problem is, our phones are great, but no one knows about us," a Meizu marketing consultant told me at a glitzy event for its new MX4 phone last fall. Not for long: In February, Alibaba invested $590 million for a minority stake in Meizu, giving the e-commerce giant a foothold in the handset market and Meizu a better shot at expansion.

LEI JUN DOESN'T look much like a disrupter. He's middle-aged, for one. He's as likely to be photographed in the uniform of the corporate establishment—dress shirts and trousers—as the jeans and T-shirts of the startup world. For years he worked at a Chinese Microsoft competitor and eventually took it public. He also worked as a venture capitalist. Part company man, part folk hero, Lei is the founder of China's highest-profile mobile contender, Xiaomi, a Beijing company with a naked desire to upend its entire industry.

In the late 2000s, Lei became obsessed with smartphones. He studied their design, operation, and business. He carried around several dozen in a backpack. Sensing opportunity, Lei used his connections in China's venture capital scene to recruit partners, including the former head of Google's mobile-search operations in China. They settled on the name Xiaomi—"small rice"—and got to work designing their first phone. The Mi1, made by the same Taiwanese contract manufacturer that makes the iPhone, went on sale in October 2011 for 1,999 renminbi ($330).

Xiaomi epitomized the lean startup. It sold phones only online—forgoing store costs and retailers' cuts—and spread its story by winning over Chinese enthusiasts eager for a national champion. "They found an innovative way to sell phones without spending any marketing dollars," says Richard Liu, the early investor. Even today Xiaomi spends far fewer marketing dollars as a percentage of sales than Samsung or Apple. "We have the world's top operational efficiency," Lei, 45, told *Fortune* this past summer.

The Chinese press likes to call Xiaomi the "Apple of China," but beyond the aesthetic imitation, it's a poor comparison. Apple devices sell at premium prices; Xiaomi's sell at low prices. Apple operates hundreds of its own brick-and-mortar stores; Xiaomi sells its wares only online or through carriers. Yet both companies are able to generate a rush of excitement with every new release. In January, Xiaomi declared that the first shipment of its answer to the $975 iPhone 6 Plus, the $370 Mi Note, sold out in three minutes.

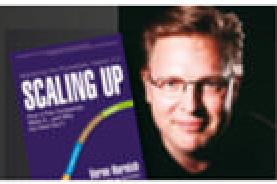
Xiaomi's overnight success—it ended 2014 as the top smartphone maker in China, ahead of Samsung and Apple—has not come without criticism. In October, Apple design chief Jony Ive said that Xiaomi's work amounted to "theft." Similarly, Meizu's Wong once wrote in a company forum that Lei copied Meizu's "phone design, production, supply chain, marketing, and even financial operation." (A Xiaomi spokeswoman de-

CHART SOURCE: TRENDFORCE 2014 ESTIMATES

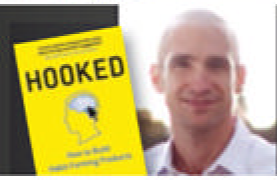
WHERE LEADERS OF SCALE-UPS MEET

"First mover advantage doesn't go to the first company that launches, it goes to the first company that scales." —Reid Hoffman, co-founder of LinkedIn*

Featured Speakers Include:



VERNE HARNISH
Chair, Leadership Summit
Contributing Writer, FORTUNE



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Neuroscience-Based Leadership and Culture Coach
How Teams Become Brilliant Together

JOHN SVIOKLA
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DAVID MEERMAN SCOTT
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*The Scale-Up Report by Sherry Coutu CBE

nied it.) Whatever the case, it's difficult to deny that there is strategic advantage in the fast follow—especially in the technology industry.

LV QIANHAO, ZTE'S handset strategy chief, is a round-faced man who delivers his English in forceful bursts. He's unequivocal in his analysis of his company's problems from its downtown Shenzhen headquarters. "ZTE is famous for low-priced products," he says. "It is not famous for the latest innovation."

In contrast to Xiaomi, ZTE has never professed a desire to reinvent its industry—just itself. The company, one of China's two telecom-equipment champions along with Huawei, is the world's ninth-largest phonemaker. But it desperately seeks to shed its image as a maker of cheap, no-name phones.

ZTE needed a better brand, Lv concluded. In 2012 the company introduced a new line called Nubia, sold exclusively online, that won buzz when China's first lady, Peng Liyuan, was photographed using one. In a bid for better visibility, ZTE also became the official smartphone of the New York Knicks as it tries to sell premium phones in the U.S.

Lv likens ZTE's situation to a horse eating a patch of grass that is surrounded by encroaching desert. "If he doesn't move, the grass will become less and less, the desert larger and larger. Alas, one day there will be no grass for this beautiful horse. The horse will die," he says. "If it only focuses on entry-class products, ZTE will become this horse."

HUAWEI, LIKE ZTE, CHURNS out enough smartphones to be a major player in its home market. But all the company cares about is being "China's most global brand." Five years ago the company couldn't crack the global top 10 brands in mobile-device sales, according to Gartner. Today it's one of the world's largest smartphone makers, behind Samsung and Apple.

The road to global dominance has occasionally been rocky. Two years ago Huawei made headlines after the U.S. House Intelligence Committee labeled the company a security threat, in part for its ties to China's military. (Huawei's founder, Ren Zhengfei, left the People's Liberation Army in 1983.) Huawei denies the committee's assertion but remains barred from bidding on large U.S. telecom contracts.

But there's no ban on consumer phone sales. Huawei is carefully managing its exposure as it expands into new markets. It sponsored 30 soccer teams, including top club A.C. Milan. It launched a smartphone line sold online in the U.S. and elsewhere, the Ascend Mate2. And last year it cracked Interbrand's list of 100 top global brands, sandwiched between Corona and Heineken.

Its strategy has begun to pay off. When Huawei launched its Ascend Mate7 "phablet"—a phone approaching the size of a tablet computer—in Berlin this past fall, some bloggers proclaimed it better than Apple's new iPhone 6. It was exactly the kind of response the company was looking for. "When we launched Mate7, our clear target was the Galaxy Note 4 and iPhone 6 Plus," says Shao Yang, vice president of marketing for Huawei's consumer group. The buzz was no small triumph for a company that two years ago was recognized by less than 25% of U.S. consumers.

THE GREAT CHALLENGE facing China's phonemakers is that their global expansion will pit them against the same multinational tech giants they bested in their favorable home market. But they can't look back. The Chinese market is saturated; at this year's Consumer Electronics Show, some 300 vendors from Shenzhen alone showed up.

It's also slowing down. After several quarters of triple-digit growth in smartphone shipments, China saw it slow to 15% in the third quarter of 2014, estimates IDC—a sign that phonemakers must begin to transition from appealing to first-time buyers to persuading existing owners to upgrade.

And then there are the legal hurdles lying ahead. With the exception of Huawei, ZTE, and Lenovo, Chinese phonemakers hold relatively few patents, putting them at risk of lawsuits that could be costly and slow expansion. In December an Indian court ordered Xiaomi to stop selling handsets after Ericsson complained that Xiaomi wasn't paying royalties on its wireless patents. "The injunction is simply an indicator that we've grown up and have quickly reached the stage that took other companies many years to get to," says Hugo Barra, the executive in charge of Xiaomi's global division. He added that the suit wouldn't slow Xiaomi's expansion in India.

AT THE AIRPORT IN Shenzhen, I run into Jerry Zhao, a 25-year-old product manager at OnePlus who is working on strategic partnerships. He's wearing tight jeans and a T-shirt and speaks in the kind of rapid-fire English you hear in New York. When I met with Carl Pei, he told me that OnePlus hired a lot of ABCs—American-born Chinese. Zhao is one of them. Six months earlier he left a Wall Street job to ride the mobile wave in China.

As we talk about the industry, he pulls out his phone. "You want to see something?" he asks, grinning. He calls up an internal chart measuring brand popularity. The OnePlus line is a hockey stick, soaring above those for ZTE, Coolpad, Huawei, and others. OnePlus is doing really well, he says, swiping through charts. "We are killing it."

The race is on. In January, Apple posted record earnings, fueled in part by a 70% increase, year-over-year, in sales in greater China. Meanwhile, Samsung has vowed to reinvigorate its mobile efforts after posting lackluster sales of its own—a result of increased pressure from Apple and Xiaomi.

The thing about overnight success? It tends to stir the sleeping giants. ■

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CEOs

$7.2
trillion in revenues

16
million employees

SO WHY CAN'T THE BUSINESS ROUNDTABLE GET ANYONE IN WASHINGTON TO TAKE IT SERIOUSLY?

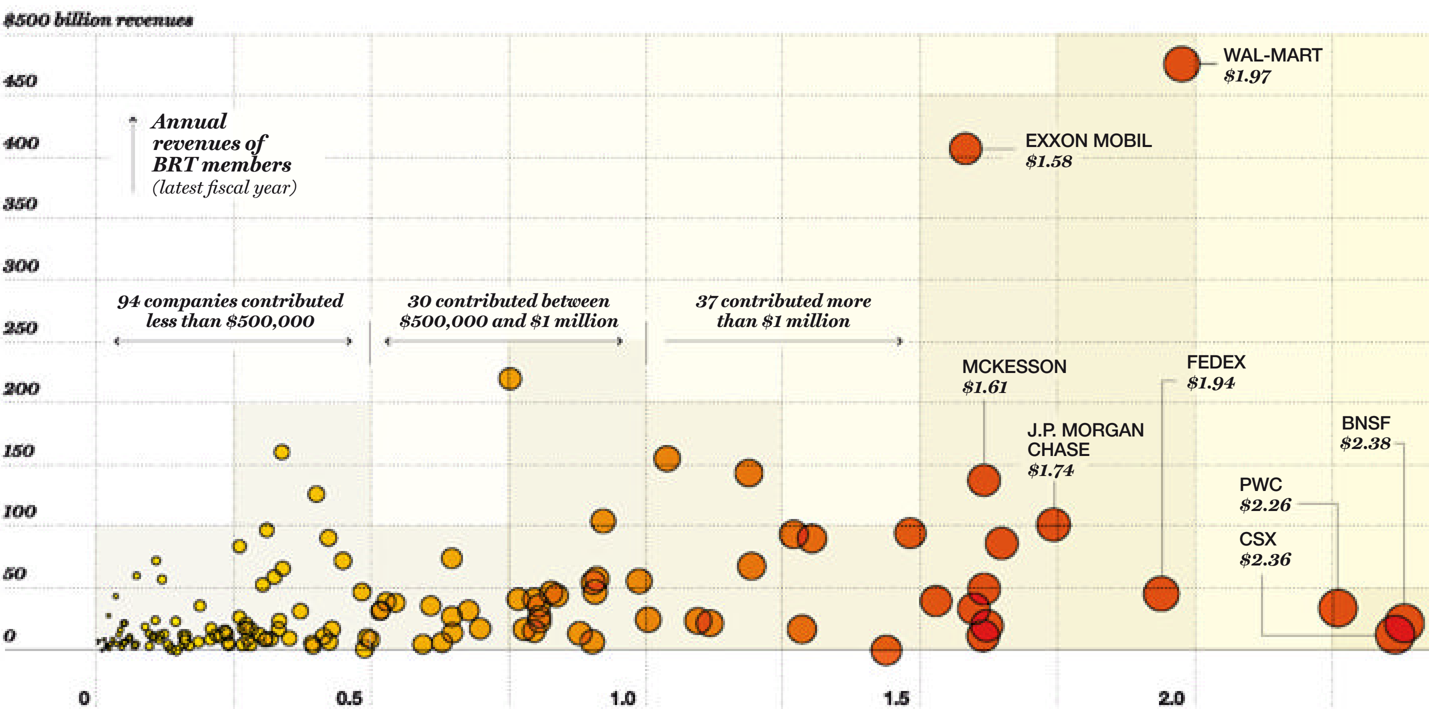
By TORY NEWMYER *Illustration by* ANDY FRIEDMAN

SUSPEND YOUR DISBELIEF for a moment, fellow citizens. Here is a fact that defies everything you've come to know and believe about the workings of American policy: Big business is a mere featherweight when it comes to getting its way in the nation's capital. In terms of shaping the broad domestic agenda, that seemingly formidable entity known as "corporate America" is, in reality, a piker. ¶ Don't get us wrong. Washington, we know, is jammed with some 12,000 registered lobbyists (with many thousands more operating in the shadows) who daily, feverishly, often expertly work the levers of government to secure narrow breaks for their company clients. Legend are the stories of corporate giveaways tucked into the latest government-funding "Cromnibus"—a term that sounds as unholy and gluttonous as it is. In a marvel of behind-the-scenes tinkering, we are well aware, emissaries for Wall Street banks managed to peel back the Dodd-Frank rule squeezing their ability to trade derivatives, as other legislative wranglers worked their magic for telecom giants, defense contractors, and countless others.

All told, business interests plowed a staggering $2.78 billion into lobbying last year in hopes of shaping the policymaking process, according to an analysis by the Center for Responsive Politics. They spent hundreds of millions more on political campaigns. And yes, without a doubt, the money bought access to legislators, key aides, and agency officials. The access brought influence. The influence, in turn, was often reflected in changes the companies pushed for: targeted tax breaks, tweaks in legislation, stalled regulations, and new impediments for their business rivals. The tale is a familiar one.

But here's the strange twist in the saga: For all the billions spent and the K Street swagger, for all the crab-cake receptions, phone-bank blitzes, and hallway huddles, for all the giveaways gotten and special deals secured, corporate America as a whole didn't get any of the major items on its legislative wish list. None. As in zero.

Consider these four big-ticket asks: an overhaul



GRAPHIC SOURCES: FACTSET; CENTER FOR RESPONSIVE POLITICS

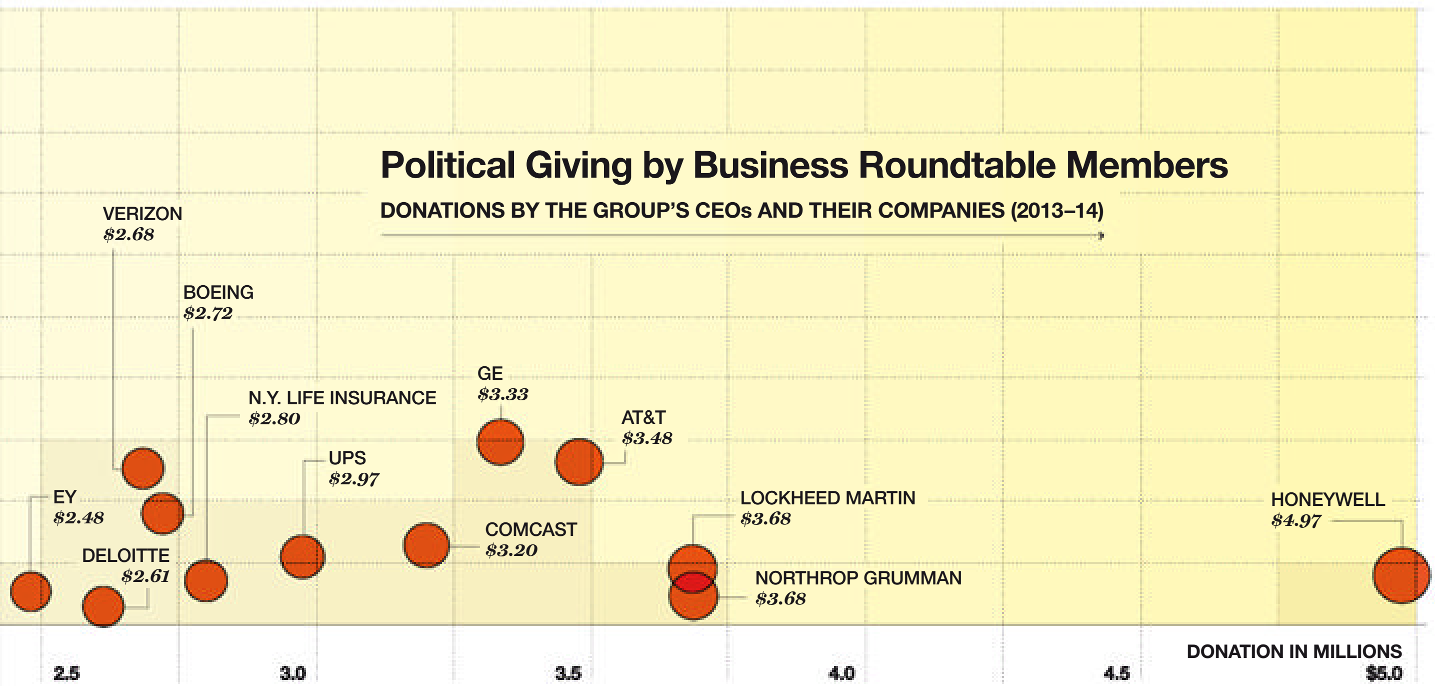
of the tax code, new foreign-trade agreements, a long-term plan for federal debt reduction and the budget, and comprehensive immigration reform. Those are the long-stated legislative priorities of the Business Roundtable, an elite group of 203 leading CEOs and perhaps the closest thing to an organizational self for big business. What America's corporate corpus truly wants now—and has demanded for years—are sensible, definitive resolutions to the core issues that divide Democrats and Republicans, President Obama and Congress, labor and management. Solve them, the argument goes, and economic growth will surge, driving unemployment down and wages up. "There's nothing else that's going to close the wage gap," AT&T CEO Randall Stephenson, the Roundtable's chairman, tells *Fortune*.

To date, all four of those boxes remain empty on the Roundtable's scorecard. As this story went to press, congressional Republicans—far from considering their own comprehensive approach to immigration reform—were squabbling among themselves about how to stick it to President Obama for his post-election executive order on the issue (which stuck it to the Republicans). House leaders are now threatening to shut down the Department of Homeland Security in retaliation. (So much for rational budgeting.) Odds for tax reform, likewise, remain long. Progress on trade alone seems even remotely possible in the coming months.

All of which brings up the question of why? Why can't America's corporate titans—a group whose economic impact is weightier than that of many entire countries, with a demographic that in theory ought to move political mountains—nudge the debate even modestly forward in Washington?

The answer, arguably, has very much to do with the Roundtable itself, a group that despite its high-powered members (or maybe because of them) has barely generated any light or heat. What follows is the story of how those CEOs lost their voice in Washington—how they stumbled into a confrontation with a new political order skeptical of their authority, one that shook loose their traditional grip on the Republican Party—and what they learned from that showdown. The question is, Did they learn enough to finally get the government to listen?

Big business can blame its current political impotence partly on its own past success. During the post–World War II economic boom, America's corporate leaders helped glue together a consensus that recognized the need for regulation and accepted the legitimacy of organized labor—though that sense of a shared mission began to fray by the early 1970s, with the rise of stiffer competition abroad and new re-



"IT WAS LIKE A BOMB WENT OFF," SAID ONE LOBBYIST, WHO FELT THE ROUNDTABLE WAS PICKING SIDES AT AN EXCEEDINGLY DICEY MOMENT.

gimes in the federal government, such as the Environmental Protection Agency and the Occupational Safety and Health Administration. At the urging of the Nixon administration, chief executives including General Electric CEO Fred Borch and Alcoa CEO John Harper founded the Business Roundtable in 1972 to strengthen the hand of corporations.

Several business lobbying groups were operating already—notably the U.S. Chamber of Commerce, founded in 1912, and the even older National Association of Manufacturers (1895). But whereas the Chamber's sprawling membership spanned the gamut from mom-and-pop companies to multinationals, the new Roundtable drew authority from its exclusivity, counting only the country's top CEOs themselves as members. It was a sort of corporate priesthood. And as Mark Mizruchi, a University of Michigan sociologist, argues in his 2013 book, *The Fracturing of the American Corporate Elite*, the group achieved much of what it sought so quickly that by the dawn of the Reagan era the need for collective action had weakened. Its sense of urgency gone, the outfit earned a rep as a club for CEOs largely to rub elbows with one another and with the governing class.

During the opening years of the Obama presidency, the Roundtable stood out in large part for being the only major business lobby that was not outright hostile to the administration—remaining at the negotiating table, for example, for most of the fight over the President's health care overhaul. That relationship soured in 2010, when the CEOs concluded that Obama's economic team was only pantomiming respect for their policy concerns. The group suddenly found itself distanced from the Democratic leadership—just as a new assault was coming from the right. The Tea Party was now stoking a wave of popular revulsion over federal bailouts of big business.

Business Roundtable chairman Randall Stephenson introduces President Obama at the group's quarterly meeting in December.

AUDE GUERRUCCI-POOL/GETTY IMAGES

At a moment when policymakers were trying to engineer a fragile economic recovery, CEOs were discovering that they had few friends left in Washington. And after the nation's near debt default in 2011, the stakes of inaction had never seemed higher.

The results of the 2012 election promised a reckoning. President Obama won a second term on a pledge to stare down congressional Republicans. His plan was to use the year-end expiration of the Bush tax cuts as leverage to seize concessions from the GOP on a sweeping budget deal. Corporate chiefs viewed it as a moment of opportunity, and with many Roundtable members included, they formed an ad hoc group called Fix the Debt to rally Washington to go big.

It was an effort fraught with peril. Failure to reach a deal before New Year's Eve would cause tax rates to spike across the board, a jolt that could pitch the economy back into recession. But this time, as another avoidable, Washington-made economic calamity loomed, Roundtable CEOs were done holding their tongue. Corporate concerns simply weren't being heard. Congress "didn't fear the business community, nor were they representing us," says Tim Keating, the top lobbyist for Boeing, whose CEO, Jim McNerney, chaired the Roundtable at the time.

In a single day in early December, Team Boeing gathered 171 CEO signatures for a letter to congressional leaders warning that the impending damage would be "long-lasting, if not permanent." And while other trade groups declined to weigh in on specifics, the CEOs went on to endorse a "balanced solution" that included new revenue from the individual side of the tax code.

To the chief executives, the missive was nothing more than an appeal for a return to sober-minded governance, based on compromise. Republicans and other business lobbyists read it very differently. "It was like a bomb went off," one lobbyist with close ties to the Republican leadership says. GOP leaders felt the Roundtable was picking sides at an exceedingly dicey moment, undercutting Republicans' negotiating position in the process.

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The blast's radius was wider still. Small-business interests—represented by essentially all the other leading trade associations—believed that the Roundtable was selling them out. Since many of their members pay business taxes through their individual filings, they viewed the Roundtable's letter as a call by the corporate elite to shift the budget-balancing burden onto smaller operators through higher rates.

Tension had already been tugging at the traditional unity among the business trade groups. Earlier in the year, Sen. Rob Portman, an Ohio Republican, convened a clutch of trade-group heads for a private preview of a corporate-only reform package he'd been assembling. Attendees say Roundtable president John Engler, a former three-term Republican governor of Michigan, endorsed Portman's approach, while others insisted it was a nonstarter: They could support only a reform push that tackled business rates on both the corporate and individual sides of the tax code, to ensure small companies didn't get shafted. Now, with the December letter urging a "balanced" approach, the Roundtable appeared to be thinking only of its own corporate constituents.

The backlash was swift. Republican leadership aides lit up the phone lines to the Roundtable to make their objections known. The starkest response came from House Ways and Means chairman Dave Camp, a Michigan Republican, who fired off a direct and public reply to the group that same day, declaring, "Big business may support raising tax rates on small businesses, but I do not."

In the carefully calibrated argot of official Washington, the Camp statement amounted to a haymaker. There are some in the GOP who still seem to feel the hurt. Kevin Brady, a Republican representative from Texas and a senior member of the Ways and Means Committee, says even today "there is some frustration lingering" among Republicans on the tax-writing panel over the Roundtable's moves during the 2012 fiscal standoff.

The fact that a single letter from a trade group could reverberate so widely and for so long helps explain why the organization remained gun-shy nine months later when yet another bout of fiscal chest-thumping broke out between the President and House Republicans. In the fall of 2013, against the better judgment of their leaders, Tea Party–affiliated House Republicans managed to drag the party into an impossible position. The GOP insisted on shutting down the government, and potentially defaulting on U.S. debt, unless Obama agreed to a repeal of his signature health care overhaul. The President refused to blink, the government shuttered, and for 16 days Republicans watched their public approval crater before finally conceding defeat.

In the lead-up to the crisis, the Roundtable once again weighed in. But this time, in lieu of a directive prescribing a solution, the corporate chieftains hewed to an equivocal call for Kumbaya, urging "both sides to adopt a new spirit of cooperation." Some in the group's ranks pressed for a stronger stand against Tea Party recklessness. But Keating, the Boeing lobbyist, muffled the group's response to avoid aggravating the wound between the CEOs and the GOP. "Every situation is an individual read," he says. "Sometimes you need to throw gasoline on a fire, and sometimes you need to throw water."

To critics, however, the episode was just another example of the Roundtable's fecklessness. Saying nothing was just as bad as saying something provocative and not backing it up with muscle.

The battles with the Tea Party did provide the Roundtable with one important lesson. In politics, ultimately the only currency that matters is votes. The groups on the new right draw their potency from their ability to motivate a dedicated corps. Republican officeholders *fear* them. Big business had struggled to make that same claim: It wasn't convincing.

Perhaps no event in the recent past frames that contrast as sharply as the shocking defeat of House Majority Leader Eric Cantor in the Virginia Republican primary last June. His vanquisher: a small-town economics professor named Dave Brat, who on the stump had bashed Cantor's support for "the agenda of the Business Roundtable and the Chamber of Commerce." The temperature within the House Republican conference changed immediately after that. "It was a wake-up call for a lot of interests in Washington that maybe a new day had dawned," says House Financial Services chairman Jeb Hensarling, a Texas Republican.

"PEOPLE WHO THINK WE ARE GOING TO GET A TRADE DEAL DONE ARE LIVING IN A DREAM WORLD."

One of the unlikely issues that had dragged Cantor to defeat, as it turns out, was his support for the Export-Import Bank. If you've never heard of Ex-Im, as it's known, that's fine with it. The federal agency was birthed in happy obscurity back in 1945, when Congress set it up to help the American industrial machine export its wares to a war-ravaged world. And it has remained a backwater ever since, offering credit financing to foreign buyers of everything from wines to jumbo jets. Today it employs 450 people—fewer than the Office of Surface Mining—most of them occupying the top five floors of a building that looks down at the White

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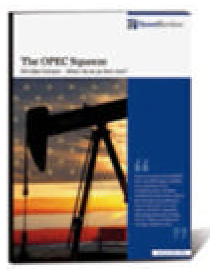
Cyber Security – A War with Gigantic Stakes

2015 could go down in history as the year of the cyber-criminals? The recent victim list now boasts the likes of Sony, Apple, eBay, JP Morgan, Home Depot, PlayStation Network, and Xbox Live.

Is this the new normal? That depends on who wins the battle for the cyber landscape – hackers, or the cyber-security guards at the gate tasked with thwarting the efforts of deviants.



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"I DO NOT SUBSCRIBE TO THE THEORY THAT WHAT IS GOOD FOR GM IS NECESSARILY GOOD FOR AMERICA," SAYS THE HOUSE FINANCE CHAIRMAN.

House from across Lafayette Square.

Yet the bank has become the staging ground for one of Washington's fiercest lobbying fights. The brawl pits Boeing, which has tapped the agency to finance more than $1 billion in exports since 2007, against Delta, which argues that those deals use American tax dollars to subsidize its foreign competition. More significantly, newly assertive free-market ideologues in the GOP are framing it as a proxy war for the soul of the party's economic policy. "The Bank of Boeing," as they call it, is an indefensible bastion of corporate welfare that must be shut down.

The Roundtable might have hugged the sideline in a war dividing such corporate titans. But through a quirk in its membership—it counts no airline CEOs in its ranks—the group has come out swinging for Boeing and other heavy-equipment manufacturers that lean on the bank, including Caterpillar and GE. To hear the Roundtable tell it, at issue is nothing less than American competitiveness abroad: The U.S. can't afford to disarm while our rivals pump up their own exports with similar credit-financing agencies.

This past September, California businessman Don Nelson flew to Washington to explain to his own congressman, Kevin McCarthy—who had succeeded Cantor as House Majority Leader and who had supported Ex-Im before Cantor's loss—why he needed the bank. Nelson's 80-employee firm, ProGauge Technologies, manufactures steam plants used for oil extraction. He says that for the past few years he's relied on Ex-Im to finance roughly $115 million in equipment sales to Middle Eastern countries, deals that private banks wouldn't back. McCarthy wasn't swayed, calling the bank a giveaway to corporate powerhouses.

Hensarling, the bank's most powerful foe in Congress, says he wants to end the bank "period, paragraph"—and in a warning to the Roundtable and other big-business lobbyists, frames the battle as "the first skirmish" in a broader struggle of Republican allegiance. He sums up his side's philosophy succinctly: "I do not subscribe to the theory that what is good for GM is necessarily good for America."

Strikingly, Hensarling's less firebrand counterpart in the Senate, Richard Shelby, who chairs the powerful banking committee, shares his skepticism. "The bigger they get, they just seem to be for themselves," says Shelby, a conservative Alabama Republican, reflecting the views of an electorate ever more disillusioned with the corporate elite. Polls bear that out. The Pew Research Center last year found that 78% of Americans believe too much power is concentrated in the hands of a few players, and most think those companies are not striking a balance between profit and the public interest. (That animus may explain the reluctance of chief executives to discuss their efforts to reclaim their Washington muscle. For this story, *Fortune* reached out to 12 CEOs on the Roundtable roster, including nine who sit on the organization's executive committee. All except for Stephenson declined to comment.)

Stephenson himself acknowledges business's diminished power in the halls of government. "We're well past the day when a CEO calls a congressman and somehow has this great epiphany for the congressman to consider how he votes," he tells *Fortune*. "What matters for congressmen today is that they hear from the grass roots."

That comment isn't sour grapes. It's the seed of the Roundtable's new strategy.

Before the AT&T chief took the organization's reins, he directed his right-hand man in Washington, Jim Cicconi—a veteran of the Reagan and George H.W. Bush administrations who also sits on the Chamber of Commerce's board—to inventory the Roundtable's weaknesses. One leaped out. The organization has long touted its members' collective economic might as the wellspring of its credibility in policy debates. But the group had no way of parsing its aggregate strength by congressional district. That is, when Roundtable representatives went to lobby a member of Congress, they couldn't say how many people the group's own members employed back in that lawmaker's district—or how many facilities they counted there, or how much was invested, to say nothing of the breadth of their supply chains and third-party vendors.

"When you're embarking on a more ambitious agenda, you want to have the ability to make it as effective as possible," Cicconi says. "That starts with some basics: finding out where Roundtable member companies have employees and matching those up with congressional districts so you at least have a sense of your own presence in each state or district." Indeed, the group's lack of that visibility was tantamount to lobbying malpractice, so mapping the Roundtable's resources became the first order of business for Bill Miller, the organization's top strategist, who was recruited in 2012 after 12 years of building the Chamber into a prodigious lobbying force.

The capacity to cite those numbers, however, is only a starting point. Next, Miller wants to summon the people behind them to press the group's agenda, since CEO voices don't carry the weight they once did inside the Capitol. Many of its member companies are already doing that for

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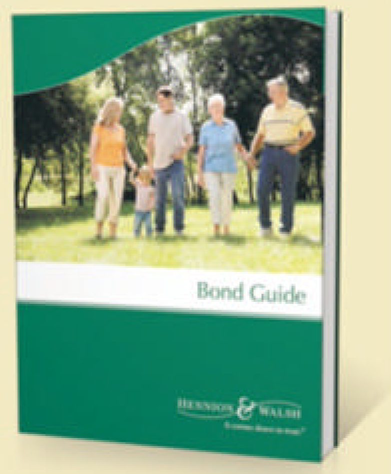

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> “SOMETIMES YOU NEED TO THROW GASOLINE ON A FIRE,” SAYS A BOEING LOBBYIST, “AND SOMETIMES YOU NEED TO THROW WATER.”

themselves. At Boeing, McNerney successfully marshaled his company’s vast supplier network into a lobbying force that in 2011 helped secure a $35 billion Air Force contract to build a refueling tanker—the culmination of a decade-long war with European rival EADS for the job. And insurer Allstate just hired an outfit called RAP Index to survey its employees’ personal ties to pols (think: kids on the same Little League team), turning up 934 such connections it aims to redeem for lobbying leverage. Miller also plans a debut for the Roundtable’s new in-house grass-roots network, assembled by mining sites like LinkedIn to find workers and other “sympathetic individuals” like retirees who’ll echo the group’s message to lawmakers. “We start off with the idea that, theoretically, we ought to be able to reach 16 million direct Roundtable employees,” he says.

The Roundtable intends to make maximum use of these ground troops in the next major battle in its strategic war plan—the fight over new international trade agreements.

Miller is holding court in a small conference room in the Roundtable’s laboratory-white headquarters, occupying the eighth floor of the America’s Square building at the foot of Capitol Hill. The structure is a gleaming glass hive of corporate lobbying that sits catty-corner to the Teamsters headquarters, a marble mausoleum for a diminished foe, and Engler moved the group here from downtown three years ago to be closer to the action. It is Feb. 5, and the action in the trade debate is rumbling to life. An hour earlier the Roundtable fired off a “CEO action alert,” calling on its members to throw themselves, plus “your executives and employees, your Washington offices, and companies in your supply chain,” into the pressure campaign to give the administration new negotiating room on trade deals. Specifically, the corporate lobby

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wants lawmakers to hand President Obama what's known as "trade-promotion authority" to guarantee that the complex pacts his team hammers out with foreign leaders will get a simple up-or-down vote in Congress. That wiggle room is seen as key to wrapping up work on the Trans-Pacific Partnership—a 12-nation megadeal linking markets from Japan to Chile that make up 40% of the global economy—and, probably later, another agreement with European countries.

The Roundtable's challenge may look steep. Congress hasn't considered a trade deal since blessing a trifecta of them in 2011, and with the turnover since, roughly a third of each chamber has never cast a vote on one. There's also a real fear among free-traders that before the debate turns to the deals themselves, populist Republicans who may not oppose new pacts per se will balk on principle at handing any additional power to President Obama. "People who think we're going to get [trade promotion authority] done are living in a dream world," one Republican leadership aide tells *Fortune*.

Cummins CEO Tom Linebarger, who is leading the Roundtable's trade push, acknowledges that the group has its work cut out for it. "If being

[redacted]

populist means you're against trade, it means I haven't yet convinced the population at large that it's good," Linebarger told reporters at a recent Roundtable briefing. But he is nonetheless confident of a win. "The data is on our side. The problem is the stories are not yet compelling enough that people understand it and agree with it. That's a job we have to do."

The odds are with them. The issue, after all, represents a rare point of agreement between the White House, congressional Republican leaders, and the business community.

Miller is plotting strategy in tight formation with the administration's economic team, hosting a weekly Thursday huddle in the Roundtable offices with coalition members, while checking in regularly with U.S. Trade Representative officials.

More than just the breadth of the President's latitude in trade talks will be settled in the bargain. If this alignment of institutional power can't get back on offense with a win here, forget the truly contentious stuff like tax and immigration reform.

Then again, if the Roundtable is successful, the words mounted and backlit on the wall of its headquarters—NOT JUST LEADERS. LEADERSHIP.—will prove more than aspirational.

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OTHER PEOPLE'S BUSINESS

Some people care about personal privacy, and others seem not to. What makes the difference?

I WAS AT A VERY BUSINESSY PARTY in the San Francisco area the other night, filled mostly with people who ride the bubble to work every day. All anybody wanted to talk about was drones. "You should see the cameras on those things!" said my friend Woodley. "They could get a zit on the end of your nose at 600 feet up!" This upset me. I asked him: "You want somebody over your backyard like that?" "Hey, man," he said, gazing at me as if I had just questioned the market value of Alibaba. "They're here. You can't stop them."

I found his *sang-froid* interesting. It seems there are people who care about privacy and those who, after all is said and done, don't. I wondered if there was a pattern, so I commissioned my friends at the National Association for Serious Studies® to perform a Serious Study on this issue. I now report their findings.

Finding No. 1: The primary determinant is age. The Level of Concern about Personal Privacy (LCPP) may be expressed as a traditional bell curve, with a fat bulge in the 25 to 54 demographic and near zero at the edges. The tentative conclusion here is that people attain a level of propriety in their middle years after a long period of heedless gestation, and that this period of maturity lasts for a while and then lapses.

Finding No. 2: Financial status is a strong indicator of an individual's LCPP. The curve starts low and goes off the chart as people have more to protect, and peaks around 3 a.m. when an iPhone alert informs you that your bank or health provider has been hacked into by idiots in Romania.

Finding No. 3: The highest level of concern is among businesspeople who conduct work online, because...

- The business day is long and tedious, and email and IMs are always at hand.
- Everybody uses email and messaging systems for personal and at times intimate purposes, from blowing off steam and making jokes to setting up inappropriate, immoral, or, sometimes, marginally legal assignations and plans.
- People take and store photos that they really shouldn't.
- There's no way to really erase anything, really.
- The Corporation knows every keystroke you make, including those in pursuit of stupid things that shall remain nameless in this report.

Finding No. 4: Nobody cares about Other People's Privacy. Ancillary points to be noted in this startling finding are...

- Disregard is greatest among the young and/or greedy. The same teens who will wander into your room without knocking have no problem snooping into your database when they go into either hacking or marketing.
- Equal levels of contempt for your privacy are registered by all vampires who make their living feeding off big data. When asked whether they believe they have the right to suck off the personal information they just gleaned from an individual who just made a transaction, they will look at you as if you just arrived on a shuttle from Planet Mambo.
- The media will print anything that comes out about you, no matter how it was obtained, and people will have no problem consuming it with glee. This is true about little people as well as big ones.

Finding No. 5: There is a strong inverse proportion between addiction to sharing and concern about privacy. That is, the more an individual tweets, Facebooks, and Snapchats, the less his own or anybody else's privacy matters to him. Personal privacy is a casualty of social media. As long as the latter thrives, we're all a few keystrokes away from the invasion of the body snatchers.

Finding No. 6: There is a camera looking at you right now.

Those are the findings. Documentation, charts, and underlying data for this study are proprietary. You know what that means? Look it up. ■

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JASON SCHNEIDER

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